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ISSUE212 02 October 2018

Optimising securities lending in dynamic times

Mary Jane Schuessler of RBC I&TS explains how the industry continues to evolve based on a changing demand landscape

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DataLend: Cash reinvestment desks in the US may have a more profitable year

Cash reinvestment desks in the US may have a more profitable year in 2018 than in years past, according to Chris Benedict, a product specialist at DataLend.

Writing in the September issue of DataLend's research publication 'Purple', Benedict said that revenue generation in the cash reinvestment space, following recent rate increases, does not seem to be increasing from an absolute standpoint.

He added that this is due to the continued decline in cash collateral balances, especially in the US.

However, a comparison of cash reinvestment revenue from the first half of 2018 versus the same timeframe in 2017 shows a 10 percent revenue increase of approximately $84.8 million year-over-year.

Benedict added: "We also see an encouraging 42 percent cash reinvestment revenue increase of $163.3 million from Q1 to Q2 2018. Indeed, cash reinvestment revenue reached a three-year high of almost $543.9 million in Q2 2018."

"This suggests that cash reinvestment revenue is seeing a bump as a result of rate hikes despite a broader trend away from pledging cash as collateral in securities lending. Cash collateral trades may be becoming more profitable on a per-trade basis due to rising rates."

However, Benedict cautioned that in a rising interest rate environment, rebate rates associated with cash collateral securities lending transactions are immediately updated to reflect interest rate changes, and the cash reinvestment side may lag.

This is due to reset duration mismatch, he explained. Overnight deposits and repurchase agreements will be reset after a day to reflect the interest rate change, but cash reinvestment in longer contractual terms or maturities will not have that option.

While DataLend has seen some fluctuations in the average net reinvestment spread for US dollars, its figures show that agent lenders are reinvesting cash collateral profitably for their beneficial owners, and generally the average net reinvestment spread appears to be on the rise.

Other topics covered in this issue included financial technology, big data, precision analytics, cash reinvestment in securities lending, securities finance revenue and emerging trends in securities finance.

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Inside SLT

securities lending times

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

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

Deputy Editor: Barney Dixon
barneydixon@blackknightmedialtd.com
+44 (0) 203 750 6026

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

Junior Reporter: Maddie Saghir
maddiesaghir@blackknightmedialtd.com
+44 (0) 203 750 6019

Contributor: Ned Holmes

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

www.securitieslendingtimes.com

Twitter: @SLTimes_

Office fax: +44 (0) 20 8711 5985
Published by Black Knight Media Ltd

EquiLend opens Dublin office

EquiLend, a provider of trading, post-trade, market data and clearing services for the securities finance industry, has opened a new office in Dublin to serve European clients following Brexit.

EquiLend's new office at South Point is the headquarters of EquiLend Limited, the firm's Irish entity.

According to EquiLend, the launch of an Ireland-based entity will enable the company to continue offering its trading platform post-Brexit to clients transacting in the EU.

EquiLend is registered as a multilateral trading facility (MTF) by the UK's Financial Conduct Authority and is currently awaiting approval by the Central Bank of Ireland for MTF status.

The firm said it will maintain its existing Canary Wharf office and MTF status in the UK to serve UK-based activity, as part of its commitment to the UK market.

The new location brings the total number of EquiLend offices to six, with presence in Toronto, Hong Kong, London and New York.

Laurence Marshall, managing director of EquiLend, said: "The ease of doing business in Ireland, its commitment to fintech and reputation as a tech centre of excellence, its location in the EU and the network of talent available here together made Dublin a clear choice for EquiLend's EU operations."

DataLend: Cash reinvestment desks in the US may have a more profitable year

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DataLend's research shows that general collateral revenues and balances are on the rise.

Balances increased 20 percent in June to July 2018, while revenue rose by 12 percent compared to the same period last year.

On-loan balances and revenue in the specials space remained virtually unchanged, calculated DataLend.

Prior to the heavy inflation experienced in the first two weeks of August, Turkey saw a 92 percent increase in bond revenue in June and July of 2018 compared to 2017, with the total on-loan value increasing by 32 percent to $48 billion. Utilisation has been steadily increasing from 8.5 percent at the beginning of the year to over 13.3 percent on July 31.

ESMA issues working paper on fixed income liquidity

Having deteriorated during the financial and sovereign debt crises, sovereign bond market liquidity has increased since then, potentially also due to the effects of supportive monetary policy in recent years, according to a whitepaper by The European Securities and Markets Authority (ESMA).

The white paper, entitled 'Liquidity in fixed income markets—risk indicators and EU

evidence', authored by Tania De Renzis, Claudia Guagliano and Giuseppe Loiacono, discusses the overall reduction of secondary market liquidity in several markets in recent years, in particular, the fixed income segment.

De Renzis, Guagliano and Loiacono noted that market liquidity is important to ensure the efficient functioning of financial markets.

Poor liquidity is likely to impose significant costs on investors and, ultimately on savers and the real economy, they wrote.

The authors set out to provide a broad overview on different dimensions of liquidity in EU government bond markets and in EU corporate bond markets, from July 2006 to December 2016.

They also found evidence of several episodes signalling deteriorating secondary market liquidity for corporate bonds, especially between 2014 and 2016.

They said: "In the sovereign segment, market liquidity seems to be more abundant for bonds that have a benchmark status and are issued in larger dimensions."

"In the corporate segment, larger outstanding amounts are related to lower market illiquidity."

In both segments, increased stress in financial markets is correlated with deterioration in market liquidity, they added.

The authors utilised a 2017 European Commission study, which showed that an increasing number of corporate bonds are hardly traded at all, probably held in portfolios of long-term or buy-and-hold investors.

De Renzis and Guagliano are both senior economists in the risk analysis and economics department at ESMA. Loiacono is a bank resolution expert and single resolution board member.

Commenting on the whitepaper, Mati Greenspan, senior market analyst at eToro, a global investment platform, said: "Liquidity in any market is an absolute essential. We try to deal in only the most liquid markets in our own particular segment, not least because when clients press the 'trade' button they expect execution to take place."

Lyxor: What happened to hedge funds' alpha since the summer?

"While hedge funds' performance and alpha were honourable until the summer, our analysis suggests that they erased about 2.5 percent of alpha since June, with no turn in sight yet in September", according to Lyxor's most recent Weekly Brief.

In the brief, 'What happened to hedge funds' alpha since the summer?', Lyxor's Cross Asset Research team explained that there was also "no turn in sight yet in September" for hedge fund performance and alpha.

Long and short (L/S) equity funds were the primary culprits and victims in recent months, Lyxor said as it broke down hedge fund performance by region. Lyxor stated in the US, managers had steadily reduced their overall net exposure and leverage since Q2.

It added: "As a result, they partially missed the summer rally. The plunge in momentum also cost in June, only partially recovered afterwards."

In Europe, funds adequately reduced their overall exposures ahead of the summer, Lyxor found.

It stated: "Unfortunately, many funds were too early in chasing value stocks, which continued to correct."

Lyxor found in Asia, funds had also turned cautious before the summer. However, they were caught in their long tech and Chinese positions, which strongly underperformed main markets, it stated.

The asset research team found across the equity space, neutral funds also suffered.

Lyxor said: "In addition to the major swings in momentum in the US and in Asia, and in value in Europe, most other factors also proved volatile. It steadily eroded their returns."

Lyxor concluded: "In our view, the difficult summer for hedge funds in general, and for L/S equity funds, largely results from one central cause—worldwide policy uncertainty."

"The shifts in trade expectations, vulnerable progress in Italy and UK, the anti-establishment push in a number of developing markets and emerging markets countries, the intensifying use of economic sanctions all keep market in feverish stance, with a limited source of uncorrelated returns. It prevents managers from deploying their strategy successfully."

NEX TriOptima joins up services to meet IM demands

NEX TriOptima has joined up its services so clients can use one trade file to calculate initial margin (IM) amounts, manage margin calls and resolve disputes with its end-to-end solution that requires just one trade file.

IM rules have been introduced under the regulatory framework of the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

The International Swaps and Derivatives Association (ISDA) has warned firms in-scope

for September 2019/20 to act now to avoid missing the deadline.

To date, NEX TriOptima has helped phase one and two firms meet the requirements by providing a solution that does not require complicated integration or installation.

Firms can use triCalculate to calculate their inputs for ISDA's standard initial margin model, while TriResolve Margin can automatically capture IM amounts and achieve an exception-based margin call process.

In addition, AcadiaSoft's initial margin exposure manager (IMEM)—powered by NEX TriOptima) can identify and resolve disputes.

Nordea Asset Management, said: "NEX TriOptima has helped us cope with the IM requirements in a very efficient and manageable way. The solution provides an easy to use workflow and allows us to operate high levels of straight-through processing with its out-of-the-box integration with both MarginSphere and AcadiaSoft's IMEM."

Raf Pritchard, co-CEO of TriOptima and CEO of triResolve, said: "We've simplified what can be a labourious process. With one simple trade file, we enable market participants to meet the demands of the new non-cleared margin regulation in a simple and cost-effective manner."

Orient Bank selects Acument net for treasury management operations

Orient Bank has selected Acument net for its treasury management operations.

The bank selected Acument net due to its real-time, automated, and powerful capabilities for reporting and straight-through processing (STP).

The decision to select Acument net came after Orient Bank's treasury department, which deals in foreign exchange, repos and securities, was looking for a flexible, easy to integrate, and robust solution to support their operations.

According to Profile Software, an international financial solutions provider, Acument net is a front-middle office and risk management solution.

This will enable Orient Bank to efficiently manage all pertinent functions in the most advanced manner.

It also allows for STP handling of treasury transactions imported in real time from various platforms, including their existing core banking Flexcube release 12.

Acument net empowers the bank to monitor all treasury related elements ranging from positions to accrual calculation, Profile Software revealed.

It also manages the full process of customer bond orders and execution on the primary market, while checking limits in real time with automatic generation of SWIFT confirmations.

As well as this, the solution also supports risk management functions for counterparty risk, market risk, and it reportedly offers a comprehensive approach to handling risk related issues so as to safeguard the bank's operations.

Sudheer Kumar, head of IT at Orient Bank, said: "Acumen net offers a full STP and automated approach to our treasury department's requirements. It updates in real time position for powerful reporting, while seamlessly integrating with the back office system."

Allocations continue to trickle into hedge funds

The hedge fund industry had its second consecutive month of inflows in H2 2018 in August, and this time the breadth of allocations was much improved, according to eVestment's hedge fund industry asset flow report for August.

Despite the improvement, it has by no means been a universally beneficial period, said eVestment. Investors have shown a willingness to stick with themes, both positive and negative, but also to change direction quite quickly.

How the rest of the year will play out given some recent macro performance slips, and these investor tendencies, is a difficult guess, it commented.

Looking at the underlying figures, investors added an estimated $4.74 billion into hedge funds in August bringing the year-to-date net flows for the industry to $15.38 billion.

Total estimated hedge fund assets are now $3.308 trillion, eVestment calculated.

In four of the five months since February, prior to August, a well below average proportion of products were receiving new allocations, added eVestment, somewhat of a concern for the health of the industry. Investors have resumed allocating to macro strategies despite performance difficulties.

Macro funds produced three consecutive months of asset-weighted performance declines ending in April. Three months later they had their second monthly outflow of 2018.

In July, funds produced losses again, and in August asset-weighted losses rose meaningfully. Despite the earlier losses, and in the face of current losses, macro strategies resumed their asset-raising success.

Managed futures funds faced a sixth consecutive month of redemption pressures in a year that has been a tough one for managed futures products, said eVestment. **SLT**

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A positive outlook

With multiple developments across the securities lending industry, Fran Garritt of RMA explains what the biggest challenges have been for the association and what it currently has in the pipeline

Becky Butcher reports

What trends are you currently seeing in the US market?

The US securities lending market continues to grow but remains well below pre-financial crisis levels due to regulatory pressures and reduced leverage in the financial system. The US is currently in a slow rising-rate environment with a current target of 1.75 to 2 percent. There have been seven 25 basis-point moves since December 2015, with two more expected this year (it is likely that a move occurred between the time of this interview and publication). The slow-moving rising rate environment has generally been positive for securities lenders who take cash as spreads between rebates, and reinvestment yields have improved. However, yields have not risen—nor will they—to pre-financial crisis levels due to reductions in reinvestment risk by securities lenders. Duration mismatches are significantly smaller than a pre-financial crisis.

We have also seen an increase in the acceptance of non-cash collateral. Since 2014 cash collateral balances have remained within a fairly tight range; but non-cash collateral balances have nearly quadrupled in that period.

What has been the biggest development in the US?

It is difficult to name just one as we have seen multiple developments occur across the industry. Additionally, most developments seem to be multi-year rather than a single big bang. From an RMA perspective, it is probably the work being done on qualified financial contracts (QFC) stay rules and the International Swaps and Derivatives Association (ISDA) stay protocols. The US rules were finalised in the second half of

2017 and we have been actively involved in terms of ISDA stay protocol. We have also put in a great deal of effort to educate agent lenders and their clients of the impending implementation, and we put together an educational primer for beneficial owners, which is available on the RMA website. I definitely encourage agent lenders and clients to take a look at it, as well as the Debevoise and Plimpton client brief on our website.

What have been the biggest challenges for RMA and how did the association face them? Are there any further challenges on the horizon?

The biggest challenges for RMA and securities lenders over the past year have involved advocating on behalf of lenders to industry regulators and educating lenders on the impacts of new regulations. The bulk of the Basel-related regulations have been finalised, with the implementation of Single Counterparty Credit Limits (SCCL) still to come and the finalisation of the Net Stable Funding Ratio (NSFR) still pending. While work remains in terms of implementation, we are in the late stages of a multi-year journey. In this regard, RMA has led efforts on advocacy regarding standardised risk-weighted assets (RWA) and SCCL. These efforts resulted in a more rational measure of RWA being finalised by Basel. This more rational method has been applied to SCCL, which is a very positive result for the industry. We are still waiting for it to be applied for RWA purposes. This may take a couple of years, but we will continue to advocate.

Apart from the Basel-related rules, RMA has been keenly involved in work regarding the aforementioned QFC stay protocol and the implementation of SFTR in Europe. The RMA Legal, Tax and Regulatory (LTR) subcommittee have done a tremendous job of advocating with the Fed on the QFC stay protocol rules, and the US final rule which came out in late 2017 reflected many RMA comments. Since the rule was finalised, the LTR subcommittee has worked diligently on educating lenders and clients on the QFC stay protocol and its impending implementation.

RMA has also been interacting frequently with ISLA in regards to SFTR. While this is a European-based rule, it will have a significant impact on US-based agent lenders and their clients. RMA has developed a working group to ensure that US agent lenders and their clients are prepared for SFTR implementation.

Finally, there have also been some recent tax-related challenges, particularly in Germany with the introduction of new rules that subject certain payments related to loans of German equities to German taxation. RMA submitted a letter to the German ministry of finance in support of an ISLA letter that sought and received important clarifications on the law's application.

What should securities lending industry players be aware of in the next 12 months?

In addition to the implementation of SFTR and the QFC stay protocol rules, industry participants should be aware of the move from London Inter-bank Offered Rate to alternative rates such as the Secured Overnight Financing Rate. While this may be a couple of years out, it is important that market participants start preparing and assessing the potential impacts.

What are the opportunities/challenges/market drivers you're seeing?

Going forward, we see opportunities in the US to move towards a more comprehensive tri-party model, which should benefit securities lenders. We also continue to monitor the development of central counterparties (CCPs) for securities lending. While volume from an agency perspective has been limited to date, development continues to take place and we are moving closer to viable alternatives becoming available. We do not expect all business to flow through CCPs, but a sizeable portion of the market may eventually migrate due to regulatory burdens on agent lenders and borrowers.

We also see opportunities in fintech. Notably, blockchain, artificial intelligence, and robotic processing all offer potentially significant opportunities for the back office, middle office, and front office alike. We believe at some point in the future fintech will completely alter trading in terms of optimisation, as well as change the way that cash and securities movements are tracked and corporate actions are monitored. Big data holds a great deal of promise in terms of market transparency.

What is RMA currently working on and is there anything in the pipeline for the rest of this year?

The QFC stay protocol and SFTR implementations will likely be the most significant items we will work on for the rest of this year. We continue to advocate for the acceptance of equities as collateral in the US. Finally, the Tax Subcommittee is preparing a letter to the US Department of Treasury on the need for tax guidance under the US tax code to address the growing demand for longer duration securities lending transactions. Many securities lenders refrain from participating in such transactions because of the uncertainty present under current tax law.

Additionally, RMA has established a working group which will address challenges of corporate actions that present a significant risk to the stock borrow/loan community and will continue to test the industry in new ways as anticipated event volumes increase and become increasingly complex. The industry has seen limited advancement on a strategic solution providing enhancements to effectively manage the inherent risk, which presents an opportunistic time to mobilise and take action. The group consists of representation from the global stock borrow/loan and asset servicing communities with a mission to identify existing as well as forthcoming challenges, collaborate among industry leaders to prioritise the greatest areas of risk, propose strategic enhancements, and coordinate with industry vendors to build a global solution. **SLT**

Less fire and fury, more wait and see

The US has experienced a radical few years under US President Donald Trump. To what extent have his executive orders and other regulations impacted US securities lending?

Jenna Lomax reports

Now is an unprecedented time for securities lending in the US. As the midterm elections approach, the US faces a new wave of governmental uncertainty, and could possibly be spearheaded in to even more unpredictability with the possible strengthening of its current Republican stronghold across US Congress.

Added to that, is the possible continued tenure of one of the most controversial US presidents in modern history—Donald Trump who, over the last two years of his presidential term, has radically attempted to deregulate US financial services.

From its own side of the pond, the US has the Dodd-Frank Act (also known as the Volcker Rule) to consider, and to the east, coming in from Europe, the Securities Financing Transactions Regulation (SFTR) approaches fast with a confirmed implementation date next year.

As of 29 June, there were circa €950 billion of equity securities on-loan from an available lendable supply of just over €12 trillion, according to an equity markets report by the International Securities Lending Association (ISLA).

It said: "While we cannot be specific around the causes of this growth, increased political uncertainty that is feeding through into economic concerns is fuelling much of this growth."

"Hedge funds and other arbitrage players are trading into the anomalies created partly by the current political regime," it added.

This finding is further reflected in another report by eVestment released at the end of August, which reported US equity managers saw net redemptions of minus $64.8 billion, a further sign of economic volatility and political uncertainty.

Collateral

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.

George Trapp, head of client relations for North America at Northern Trust, global securities lending, said: "Over the past year US equity markets indices have reached new highs and many clients took the opportunity to reassess their securities lending programme objectives. We have seen a number of clients expanding their programmes by accepting a wider variety of collateral."

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."

A sign of the times

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

Although, 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, US President Donald Trump, has a different agenda through his executive orders across the first half of his current term, as well as last year's signing of the Financial CHOICE Act.

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, head of US business development 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.

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 over US financial services, of which the latter could last another fifteen months, until the next possible inauguration in January 2020.

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 explains.

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

But despite this decline in market correlation, OCC found that in it's most recent monthly report, total cleared contract volume in August reached 433,740,316 contracts, an increase of 10 percent compared to last year.

Equity options volume reached a total of 384,002,068 contracts, a 17 percent increase from a year earlier.

But while options activity looks like it's rising positively, it's important to remember that's only one slice of the American securities lending pie to digest.

Predicting the future

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

In January this year, 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.

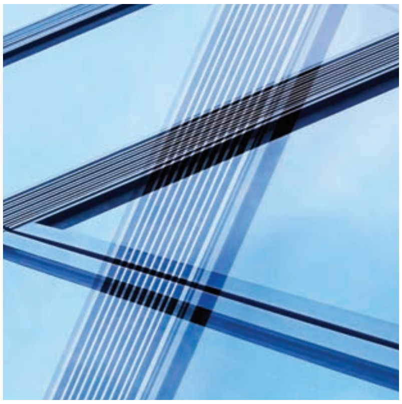
Conflicting views around the appropriateness of the measures, which are less strict in other major markets such as the EU, has been ongoing since the implementation of the rule began in 2014.

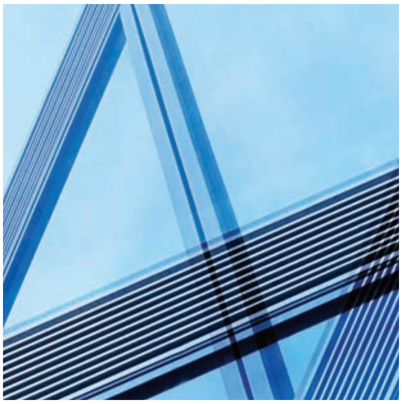
However, looking forward to 2019, there seems to be an understanding of a re-shaping of, not just securities lending, but of financial services as a whole.

As Trapp says: "In 2019, we expect to see the initial impacts of stay regulations under various special resolution regimes, including the US. We also anticipate the release of further regulations on the UK's SFTR regime."

He adds: "These two sets of regulations have a broad global impact, with the potential to reshape the landscape for cross-border securities lending."

"Although these [regulations] are expected to be significant changes for the market, we are optimistic that the market will absorb and adapt positively to these regulations in much the same way it did to the Volcker Rule and other Dodd-Frank era rules." **SLT**





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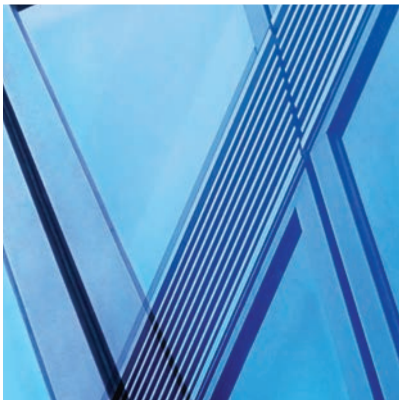

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Collaboration is key

As the likes of Mexico and Brazil are well established, other countries in the Latin American region, such as Chile and Argentina, are well on their way to successfully expanding their securities lending programmes

Jenna Lomax reports

As it stands, Brazil is the largest market in Latin America, with Mexico following behind. Although individual countries are all experiencing some economic and/or political challenges, they are, for the most part, all emerging markets with promise.

Mexico and Brazil are the only markets in Latin America to count for equity finance at the moment, and though Colombian, Peruvian and Argentine markets are at different stages of development, they are all working towards having more functional securities lending markets.

As Roberto Belchior, managing director and Latin America market development head at Brazil's B3, explains: "Latin American markets present enormous opportunities for local and foreign investors."

Belchior adds: "Despite the volatility that has been shaking emerging markets across the globe, regional markets have proven resilient and have been enduring these difficult times. Political and macroeconomic stability should ultimately result in tangible progress in the coming years."

Brazil

"Brazil has thrived in the last decade, becoming a leading listed derivatives market and [also has] a strong and deep equity market", according to Belchior.

And as claimed by a recent publication, 'Purple' by DataLend, the Brazilian economy has rebounded strongly in the last two years, but the country's politics is putting pressure on growth.

It says: "The general population is disenchanted with its political class and will likely use the general elections in October 2018 to express that view. The run-up to the election and the result is likely to increase market jitters."

However, despite these upcoming doubts and worries concerning politics, Brazil is still leading the Latin American region for securities lending.

Belchior says with markets rebounding from the worst financial crisis in its history, B3 in particular "has invested massively in renovating its trading and post-trading infrastructure and has been working closely with its client base".

B3 are pushing a new initiative aiming at facilitating the matching between lenders and borrowers with a new trading screen. The new electronic platform will be available to both buy and sell side.

Furthermore, there is an ongoing addition to the list of securities available for lending, this includes the addition of the Unsponsored Brazilian Depositary Receipts, planned to be released in December 2018 and the Fixed Income Instruments, expected to be launched by mid-2019.

In addition, the Banco Central do Brazil announced its release of a range of operations, including repo and bond sales, of which DataLend states has fed through into the securities lending market.

Mexico

For the first time in over four decades, Mexican voters have elected a left-wing president. This political anomaly, coupled with US President Donald Trump's choice to rewrite the North American Free Trade Agreement (NAFTA), have made Mexico's market uncertain and volatile.

To a certain extent, there is a 'wait and see' attitude in terms of confidence in the markets, and this may not change for a while, until Andrés Manuel Lopez Obrador is well into his first year with his party, Morena.

Though where securities lending is concerned, Nacional Financiera, a development bank, wholly owned by the Mexican government has utilised a working group, in association with the Risk Management Association (RMA) to promote foreign participation at the securities lending market in Mexico.

However, there is currently a significant demand to borrow securities that isn't currently being met, with more than 60 percent of the outstanding amount being held by foreigners.

But moves are being made to improve this. Bolsa Institucional de Valores (BIVA), for one, was launched in July. BIVA trades the same instruments as the other exchange in Mexico (Bolsa Mexicana de Valores) which includes covering equities.

As Federico Ortega Gilly of Mexico's Nacional Financiera, explains: "We are keen to improve the Mexican market's liquidity by adding more securities to the pool."

Gilly Ortega adds: "It's in everyone's interest to see the securities lending market grow in an efficient way that draws in more market participants. We have been working with the RMA and the central bank to design a new model to see if foreign entities can do more in local markets."

Chile

Chile is a "fairly thinly traded market", according to DataLend, with approximately 125 securities on loan on any given day, almost all of which are fixed income.

DataLend comments that these securities on loan consist of "a mix of corporate, agency and sovereign bonds".

Chile's securities lending model is only utilised to cover fails or facilitate short selling of equities. While short selling is permitted, this is only via an authorised local broker-dealer. Fail coverage can be executed by the Bolsa de Comercio de Santiago—Chile's dominant stock exchange.

But despite this diversity in types of securities, Chilean equities are underperforming after a stellar 2017.

In a blog by Brown Brother Harriman, it was stated that in 2017, MSCI for Chile was up 39 percent versus 34 percent for MSCI emerging markets.

So far this year, MSCI revenue for Chile is minus 14 percent year-to-date and compares to minus 9 percent YTD for MSCI emerging markets.

But, let's not forget, Latin America is an emerging market and change is coming to the region.

Chile's Santiago Exchange, the largest exchange in the country, recently announced a partnership with computer manufacturing firm, IBM to introduce blockchain technology across the country's financial sector.

The agreement makes the Santiago Exchange the first stock market in Latin America to apply IBM Blockchain technology to its short-selling system for securities lending.

The solution is designed to help reduce errors, possible fraud and processing time for each transaction, while also improving transaction management and lowering costs.

Argentina

Having spent the last few decades under the strict control of the local regulatory authority, the country's financial market is gradually getting freed, but is currently facing high inflation and has a generally weak peso.

Because of this, the future remains unclear for now, while Argentina's National Securities Commission still remains cautious on short selling.

However, Argentina's stock exchange, Bolsas y Mercados Argentinos (BYMA) has recently updated its trading rules and incorporated securities lending to the regular cash settlement process.

As Belchior explains: "As part of a complete revamping of its processes, BYMA has launched initiatives that now enable investors trading onshore Argentine equities to short and lend/borrow equities at BYMA."

He adds: "The new securities lending feature is also aimed at strengthening the settlement process. BYMA continues to work on the enhancement of trading functionalities and the development of new products."

Peru and Columbia

Peruvian Lima Stock Exchange has been working on the development and implementation of a functional securities lending market that is expected to become operational in coming months.

Peru's securities lending programme was recently shaken up by North American securities markets shortening their settlement cycle to T+2 from a T+3 cycle last year.

This affected securities across equities and corporate and municipal bonds, and unit investment trust trades in Peru, as well as in Mexico, and Argentina.

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

In Colombia, securities lending is utilised to cover fails or facilitate short selling legal framework, which is regulated by Bolsa de Valores de Colombia, The Office of the Financial Superintendent of Colombia and The Securities Market Self Regulator.

Operationally, securities lending is administered by The Deposito Centralizado de Valores de Colombia.

Alike it's neighbour, Chile, it remains very regulated and "local" in nature, according to the RMA.

Everybody needs good neighbours

A good example of collaboration between Latin exchanges has been the agreement entered by the Brazilian company, B3 and Argentina's BYMA.

The two have collaborated, which has enabled BYMA to launch a newly created listed derivatives market.

Belchior says: "[This has] proven to be a perfect way of leveraging the tremendous operational capacity created by B3 as a result of massive investments over the years."

He adds: "Financial markets infrastructures should seek to cooperate and collaborate more as a way of reducing costs and leveraging operating capabilities."

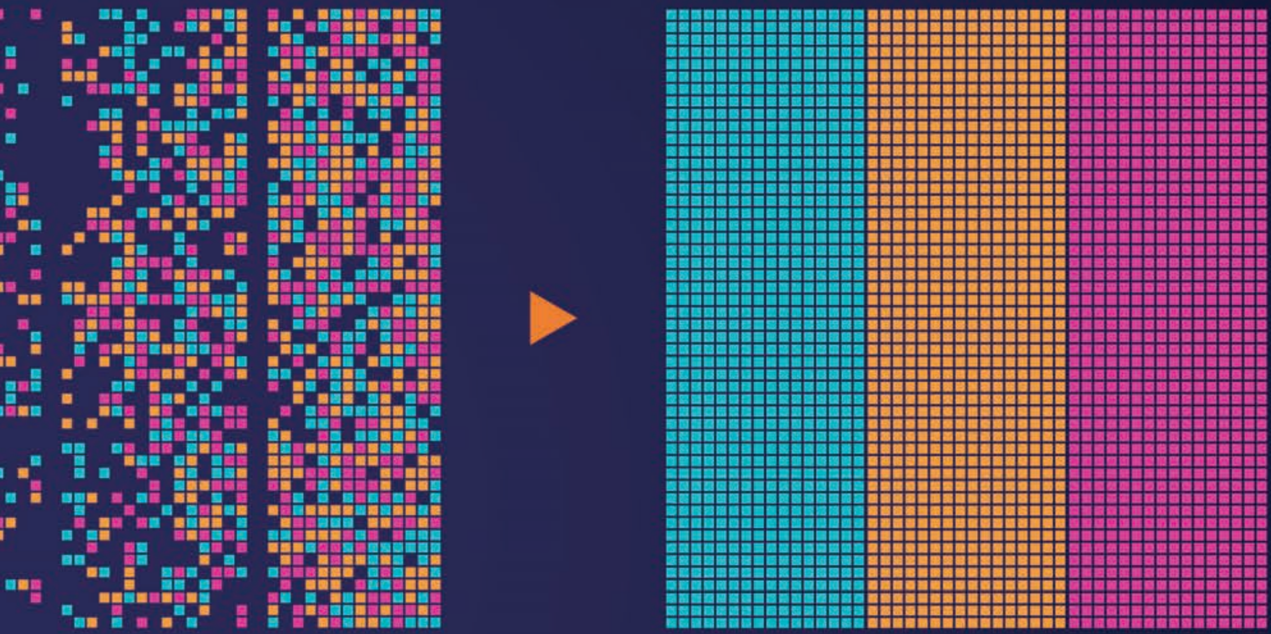
"Investors with large long positions should feel comfortable with using existing securities lending mechanisms available in Brazil, Chile and Argentina as a way to shore up revenues and manage risks adequately. That would certainly help with increasing activity in local securities markets."

This sentiment is also reiterated by Gilly Ortega. From a Mexican perspective, but with collaborative hopes for the region, Gilly Ortega says: "Our efforts as a region should be towards creating a Latin American association for securities lending, similar to the Pan Asian Securities Lending Association."

He adds: "Independently, other South American countries are starting to dig into securities lending markets, they want to settle." **SLT**

A WINNING COMBINATION

Aurélien Manson of CACEIS explains why securities lending paired with machine learning is a winning combination



To reduce the workload of securities lending desks and enhance client returns, asset servicing companies are employing sophisticated machine learning algorithms developed in-house. Such companies offer securities lending programmes to pension funds, insurers and asset managers that use sophisticated artificial intelligence software to raise efficiency in pricing corporate bond loans.

The self-optimising algorithms at the heart of this artificial intelligence (AI) technology improve themselves with each iteration especially when they are able to work on large data sets, and lending programmes equipped with such technology are already seeing enhanced returns and reduced risks, which help bring them into line with leading players in the market.

For securities lending operations, machine learning and AI will be a key part of the business going forward, not just in the securities lending space but across all front and back office operations. Straight-through processing (STP) automation was the industry's buzz phrase years ago, and indeed automation rates are still an important efficiency metric, however, machine learning has little in common with the former. Machine learning is a process based on powerful algorithms that constantly improve themselves in order to achieve better results each time. There are many everyday examples of machine learning in action, from natural language processing in speech recognition to YouTube's video recommendation engine.

For the asset manager, the only noticeable impacts on the day-to-day business of machine learning in securities lending are faster responses, increased reliability, lower risk and improved remuneration opportunities. Many asset managers are seeing the benefits of leveraging massive datasets, computing power and machine learning software to optimise their trading and enhance yields.

Machine learning is having a positive impact on remuneration opportunities within securities lending and is also helping to reduce rates of operational error risk. In the current environment, where revenues are under pressure due to increasingly restrictive regulations, the use of machine learning to raise the efficiency of the standard securities lending process represents an important business development opportunity.

Securities lending desks receive large volumes of email every day quoting many underlying holdings and to quote a competitive price, it is necessary to check over 20 features for each asset. Companies need to think smarter rather than just increase manpower for such tasks. Automation and STP can only take you so far, but true machine learning is providing a revolutionary solution.

Leveraging innovation within a mature product category is a central part of asset servicing providers' strategies. Asset servicing firm must offer up-to-date technology to clients. New technologies such as machine learning enable businesses to allocate human resources in a more efficient way, so it's a win/win trade. Human resources focus on the added-value tasks, and the more repetitive and robotic tasks can be automated and then incrementally improved via machine learning techniques.

Most companies today are looking at how automation can improve their internal processes and many find that a high percentage of low-value administrative tasks traditionally performed by humans can be taken on by AI software. However, human traders remain essential for managing parameters further up in the process and still out-perform AI in soft data situations such as news analysis, profit warnings, bad/missing data or features not taken into account by the algorithms.

By reducing the role of humans in the process, and replacing them with well-designed AI software, error risk sees a corresponding reduction. A key role for custodians is to have visibility on and restitution capabilities for client assets. Machine learning algorithms make it possible to track each asset to determine how much can safely be lent/or needs to be borrowed to rebuild a buffer.

Machine learning algorithms: a look behind the scenes

When emails from counterparties arrive, algorithms scan them for information on asset types and quantities. Next, they automatically poll a database of lendable assets, verify that the trade meets the rules in terms of tradable size, risk limits, liquidity risk and so on, then send an email response directly to the counterparty.

Most machine learning algorithms don't have free reign in this context and are solely used to initiate the negotiation, however, advances will enable it to handle progressively more, from processing incoming emails all the way to the final booking, with human intervention only when necessary for client relationship matters.

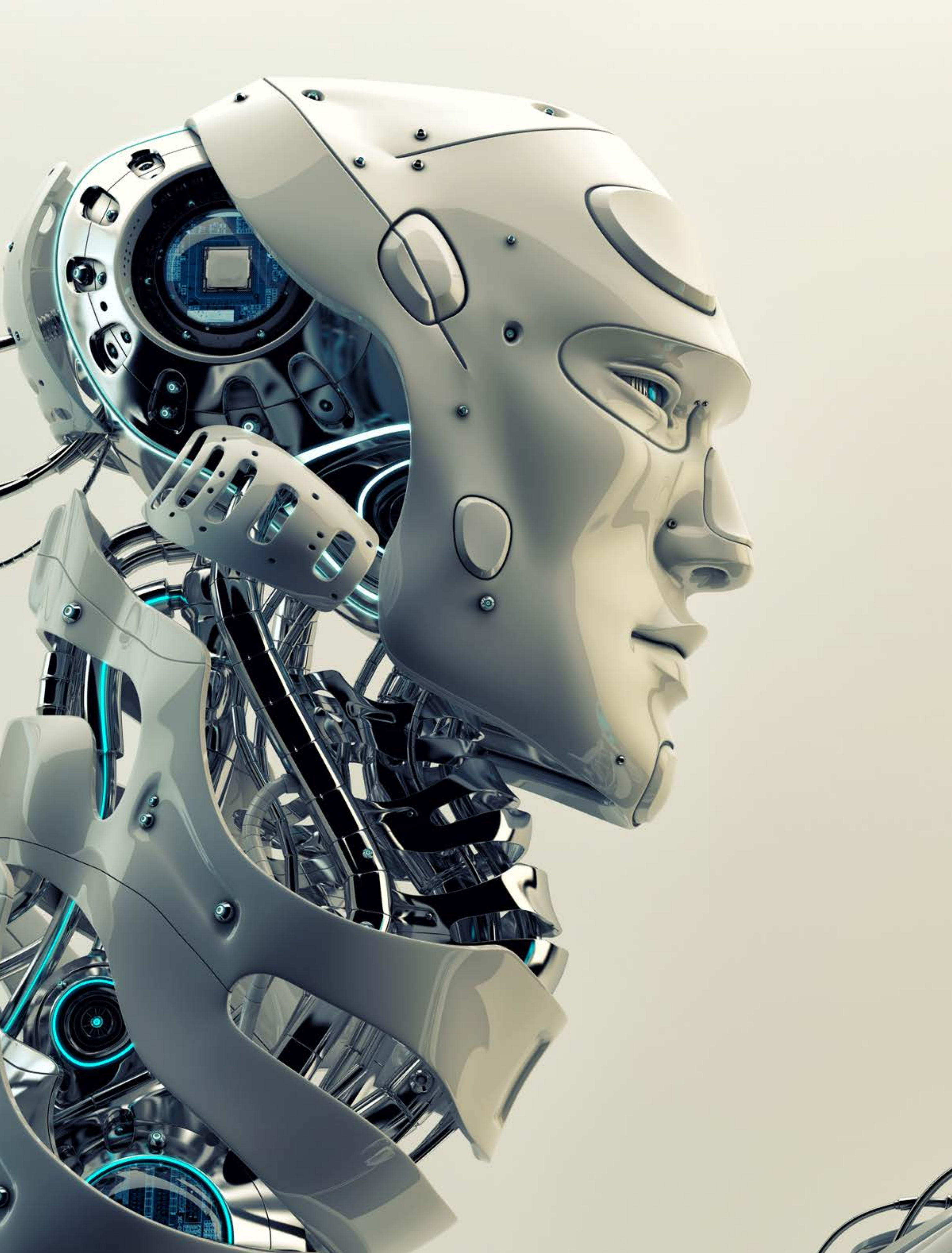
In technical terms, securities lending desks must completely model a corporate bond within their systems, using more than 36 variables to classify the bond by three features: the level, the sensitivity to the utilisation rate, and the convexity. Polynomial regressions and trees are the main analyses used to perfect the model, which is performed on an extensive lendable assets directory to create a vast reference database.

To understand how the algorithm operates, imagine lendable assets are coordinates within a 3D space and the three axes, x, y and z correspond to the level, the sensitivity and the convexity. When a new bond needs to be priced, the technology models the bond calculates where its coordinates place it, then look around that point for the nearest neighbours. Using a k-NN algorithm, where k is the integer, you can, for example, look at the three 'nearest neighbours', and even weight them according to their proximity and provide a very accurate figure with the most efficient lending level.

It's certainly a very technical topic, nevertheless, we have the award-winning expertise within CACEIS, and are also strengthening our collaboration with Crédit Agricole's DataLab department, which centralises group-wide efforts to leverage innovative fintech solutions. Our clients will benefit greatly from the increases in efficiency, speed and returns that our investments into technology seek to provide. **SLT**

> ***"Automation and straight-through processing can only take you so far, but true machine learning is providing a revolutionary solution"***

Aurélien Manson
Repo and equity finance trader
CACEIS



Applying AI to securities finance

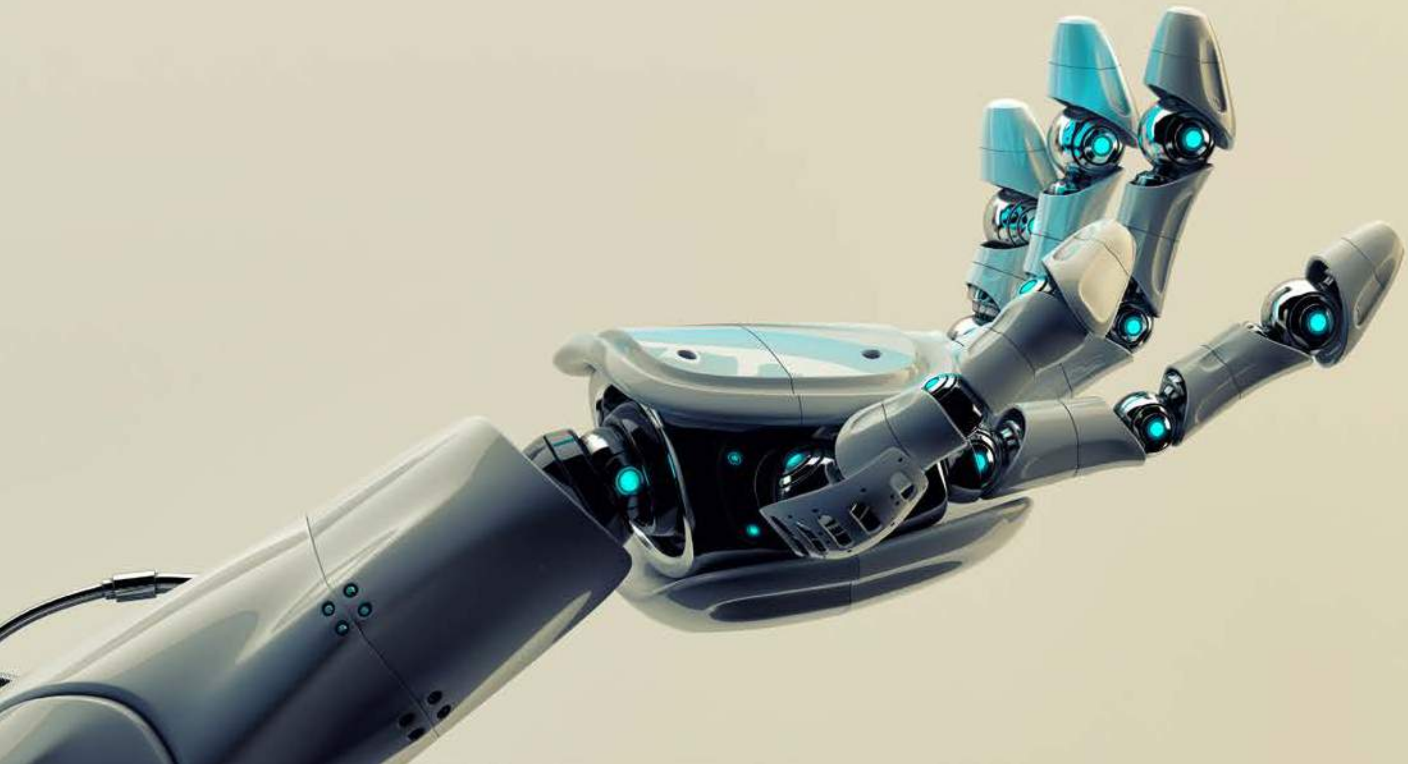
Michael Saunders and Kevin Stahl of BNP Paribas provide an insight into why technology innovation is important and how its efficiency can equal greater profitability for clients

Technology is the critical competitive element in our business today, ranging across all capital markets activities, including securities lending. However, technology innovation is a difficult task to master, the current pace of change is fast and a bank can rarely be sure that a technology at first look will be reliable, secure and fit for purpose.

A recurring theme in technology innovation is that efficiency equals greater profitability for clients. We see this both directly through increased trading opportunities, as well as indirectly, as our lower costs mean that we can be increasingly effective in the marketplace. This, in turn, encourages more counterparties to trade with us and keeps our client pricing competitive.

A technology vision

The substantial advances in technology that have occurred in recent years give rise to a complicated question: what makes a bank? Some traditional banks now view themselves as technology companies first and banks second. Others take the approach that banks should be strong in technology, but that banking services are the foremost



priority. We are trying to find a middle ground: we are a bank, but also need to stake out a leading position when it comes to new technology, especially in artificial intelligence, blockchain and other potentially game-changing innovations.

Our operating vision of technology is to identify and deliver client benefits. We are working to help our clients and internal teams make better decisions, increase response times, reduce operational breaks and identify trading opportunities. Three focus areas for us are artificial intelligence, smart data and blockchain. We have a big picture view of what new technology at a bank can look like, and while it is different than historically traditional processes, we find that it can make a big impact on how well we conduct business.

Applications for technology innovation

We are in the process of creating a predictive analytics tool, Smart Chaser, to identify the trades most likely to fail before they occur. This innovative tool will help middle office teams focus their efforts on the most problematic trades before becoming a settlement issue, thereby helping to increase settlement rates and reduce settlement fails. The system then suggests smart email 'chasers' to counterparties to generate a successful outcome.

Smart Chaser works by analysing thousands of failed trades across 100 individual factors, then matching those factors against existing trades to map the likelihood that a trade may be problematic. Analysis factors include the time of the trade, the value, the location of the counterparty and of course the broker's history. In our prototype version, we've found 98 percent accuracy in predicting the probability of trade fails to date.

In future deployments, we envision the system reading emails sent by counterparties warning of potential trade problems and then sending out automated replies. This takes the 'smart' idea of artificial intelligence to the next level based on historical trading patterns. It might also be possible in the future that our factor mapping can be combined with automated email analysis to both predict problematic trades and automatically generate emails to the counterparty.

We think that artificial intelligence has the potential to be impactful, from improving the scalability of our resources to providing greater visibility and auditability of transactions (see figure one).

We estimate that up to 30 percent of trades on behalf of institutional investors require some degree of manual intervention to finalise. When combined with existing industry platforms, Smart Chaser will mean fewer fails, which in turn reduces fees and increases client profitability. We expect to deploy Smart Chaser in securities lending in the future.

Neolink is BNP Paribas's client reporting platform, but it also is becoming a real-time trade monitoring tool delivering customisable data. Since the volume of data can be excessive to take in visually, Neolink will soon include a virtual assistant that uses cognitive algorithms to help clients mine information and find results quickly.

We use natural language processing to make this happen, which is a substantial advance compared to static report delivery in PDF. When combined with the tools that many of us carry in our pockets—Siri for iPhone, Alexa for Google or any other voice recognition platform—Neolink becomes an extension of how we would ask a person to find information anywhere in the physical world.

Artificial intelligence is driven by data—no innovative technology solution is possible without it. At BNP Paribas, our approach has been to create a data hub to focus specifically on opportunities and use cases in smart data deployment. The idea is to harness data to create innovative services.

As a bank, we have the privilege of accessing detailed data on client businesses and their activities. The aim of Smart Data is to implement intelligent services in order to benefit clients and internal operations. It will capitalise on data that we produce and receive (big data).

Our programme leverages the power of a new infrastructure by teaming up with other business lines from the BNP Paribas Group CIB's Data Hub infrastructure. Thanks to new technological applications such as analytics, artificial intelligence, deep learning and predictive analysis, we will be able to improve client experience and its sales strategies, particularly the way in which we target clients.

BNP Paribas took an early first mover approach towards blockchain; we thought it had a variety of applications in banking. In December 2016, we completed our first real-time, cross-border blockchain payment

Figure one: how artificial intelligence is impacting the banking industry

Source: BNP Paribas
https://publications.bnpparibas/securities-services-3-0/1-en/r/one-minute-with-philippe-ruault-chief-innovation-digital-officer/

as part of our 'cash without borders' concept. The cash movements settled in just a few minutes across three European countries.

We deployed a private blockchain in our own treasury group and integrated it with our legacy technology. We found meaningful operational efficiencies from the test, including a better ability to manage cash across different international businesses.

Our work in blockchain remains in the early stages; we see more pilot projects in our future and perhaps a potential opportunity to leverage our existing efforts into full-fledged businesses. Changing internal behaviour and the external market takes time; we expect that these initial efforts will build momentum over time and may wind up being incorporated in later efforts that have broad commercial applications.

Impacts for securities finance

The securities finance marketplace has moved quickly from an electronic market, including emails and proprietary data feeds, to an electronic platform. An estimated 70 percent of our market's volume is now conducted on electronic marketplaces with minimal human intervention, and this includes virtually all general collateral and some of our specials as well. The figure will likely never reach as high as 90 percent as there will always be trades that require human intelligence to sort through. However, we can see a day when, after credit approvals are complete and lenders have signed off on collateral acceptance policies, almost all trading that occurs will be automated to some degree.

In an era where computers make loans to other computers based on pre-set parameters, how can we continue to offer value to our clients? Our response is to maximise our expertise to support a mix of efficient operations, pricing optimisation and a focus on the client experience. In operations, Smart Chaser is one example of how we are helping our teams focus on the most likely to fail transactions, which reduces fail costs and operational roadblocks.

In pricing, the use of smart data across multiple sources can be used to discover optimal prices for securities loans, including supply and demand characteristics for each individual security. And in the client experience, Neolink is how we are using artificial intelligence to bring forward data, insights and information using natural language processing.

We see a range of new opportunities on the horizon for technology in securities finance. While all developments and innovations are important, we are realistic—knowing that every technology opportunity may not be the right fit. However, in securities lending, we expect to take advantage of core research being conducted here at BNP Paribas.

Our intention is to then share this innovation through our business activities and client offerings. **SLT**

Kevin Stahl
Head of business development for market and financing services, securities services North America
BNP Paribas

Michael Saunders
Head of investments and trading, securities lending North America
BNP Paribas

Technological revolution

Laura Allen of Trading Apps discusses the potential technological revolution on the horizon within the securities finance industry

Maddie Saghir reports

Is there a technological revolution on the horizon within the securities finance industry?

We think that there most certainly is. New technologies will continue to find their way into an industry that has always been a bit cautious and deliberate in the past. And to that point, we believe that the adoption of the technology will, by virtue of the existing setup, have to be an organic rather than a revolutionary process. We are optimistic that post-Securities Financing Transaction Regulation (SFTR), there will be positive momentum from the existing players, but also participation from new market entrants (for example, direct lenders) that will experience some of the disjointed and rather outdated solutions and challenge the status quo by asking difficult questions and demanding change.

Where are the main opportunities for technological innovation in securities finance?

In terms of new technologies, we see distributed ledger technology (DLT) increasingly offering solutions for settlement and operations but also for pre-trade negotiations. We also see robotic process automation (RPA), which our Lender App implements, as a way to retain the benefits of legacy investment whilst moving to more exception based processing. Lastly, we think there will be economies of scale and standardisation through hosting and platform consolidation as part of middle and back-office outsourcing solutions. More generally, having seen a number of clients engaging in spend-to-save programmes, and with the ever-present focus on cost-reduction, architectures that aid decommissioning of legacy solutions or promote efficiency through better integration of the existing infrastructure will help in all business lines.

What challenges are firms facing?

Securities finance systems are deeply embedded in participant's infrastructures, therefore any change is not limited to just the stock lending silo but will impact wider operational, risk and regulatory platforms. This creates in-built resistance to change and makes agreed improvements slower to implement as they pass through the governance, build and testing lifecycle of each dependent platform. We would also say that regulatory enhancements have had management focus, and although a cliché, it's also a truism that regulatory budget is one of the few reliable growth areas in banking IT.

How are businesses updating their processes to optimise operations?

Businesses are still aspiring to the holy grail of full straight-through processing and exception, based processing, and are seeking automated booking tools for market and internal trades. In addition, they are implementing sophisticated inventory management, flattening internal shorts versus longs with full transfer pricing, generating auto-short cover or auto-return trades and automating the pull and distribution of long inventory for collateral or financing purposes. Systematic recalls across loan and collateral positions reduces settlement fails and automated bookings reduce contract breaks thereby improving operational efficiency.

Are you finding firms building new systems or building upon what they already have? Are there arguments for both build versus buy?

We are finding they are doing both. As a vendor we manage that approach by having a hybrid product/development team philosophy. This means that we are responsive to each client's needs in a way that an in-house development team could be, whilst maintaining an architectural awareness of the product as a whole. The arguments for build versus buy are the same as they have always been. If a vendor has a product that has commoditised the functionality and ticks most of the boxes, it would be difficult to argue in favour of embarking on a build programme when faced with the in-house build cost and risk, and particularly the opportunity cost of not using that development team on differentiating, value-add work.

What is the demand for cross-product systems in the market?

We certainly receive a great deal of requests for a system that can handle securities lending, repo, and derivatives related workflows. Given the efficiency plays that most of our clients and prospects are after, a technological solution needs to be flexible enough to support multiple products across multiple business lines across the global marketplace.

Five years from now, how do you see the securities lending market developing in terms of technology?

It will be very interesting to see if the industry embarks on replacing the tried and trusted platforms that have been the work-horses of the securities financing business to date, or whether how, or indeed, if the established platforms embrace newer technology such as DLT and peer-to-peer. We think the standardisation of data is a problem waiting to be solved, with all the operational disconnects that result from different prices, instrument static, corporate actions data on the day to day business flows. It certainly goes without saying that automation, transparency, algorithmic trading and the utilisation of distributed ledger and AI technologies will certainly play an ever increasing role. **SLT**

"Automation, transparency, algorithmic trading and the utilisation of distributed ledger and AI technologies will certainly play an ever increasing role"

Laura Allen
Managing director
Trading Apps

Time to be forward thinking?

Tim Smith of FIS Global discusses trends in the North America securities lending market ahead of this year's Risk Management Association conference

This year's Risk Management Association conference in Miami opens amid the seemingly perennial and continual regulatory and transparency focus, the same as it has been for the last 10 years. The General Data Protection Regulation, Securities Financing Transactions Regulation and Consolidated Audit Trail are all having their impact and every business is increasingly having to spend more and more time satisfying internal audit types looking to ensure that every one of these regulations and more are correctly reported on and no infringement at all is in the offing. My colleague penned a piece in the last issue of SLT on the accelerating impact and influx of technology required to ensure that we can undertake our business in good order and a timely fashion, and this is indeed the case.

However, we should not forget the fundamentals of what is happening in the North American markets, whether it be upward pressure on rates, an evolution of collateral in terms of type and quality, or even the increasing desire to achieve the ideal of using machine learning and predictive analytics. Not only efficiently monitor positions, but also get ahead of the game when it comes to re-rates and potential borrows or loans. This securities finance environment application of the society envisaged in films, such as The Minority Report, is surely where we all wish to go—and it may not be too far away.

First things first though, let's look at the general trends in the North American securities lending market over the last year applying the usual measures. Figure one and figure two (on page 39) show the trends in terms of availability, volumes, rates and the split between cash and non-cash collateral. Immediately apparent is the somewhat easing of the desire to pursue non-cash collateral. On the back of slight rises in interest rates, it appears that cash may have regained some of its allure. In terms of volume, we can see that these have picked up in terms of value as have the relevant indices. Availability has increased in parallel with this trend as well. Average rates, however, would appear to have eased off, maybe as the result of increased availability leading to easier-to-borrow securities.

In any event, this is all anodyne and even intuitive at the macro level—some might even say boring so let's get back to the future and see if any of this summer's causes celebres have anything to offer us. The last few months have been eventful for Tesla and considering everything it's been in the news for, the whole debacle could be analysed to see if it tells us anything from the securities lending front. We could all say what we would think would happen, but you never can be too sure and if we are ever going to get to that predictive state then we need to carry on analysing to the nth degree.

Figure one and figure two depict activity on an intraday basis for Tesla on and around the days of the following events—asking suppliers to delay invoices, an announcement that Tesla might go private, resignation of the CFO after one month in the job, Elon Musk smoking funny tobacco and the announcement that they are not going to go private after all. The first thing to note in terms of a common trend is that there would appear not to be a common trend.

Figure one

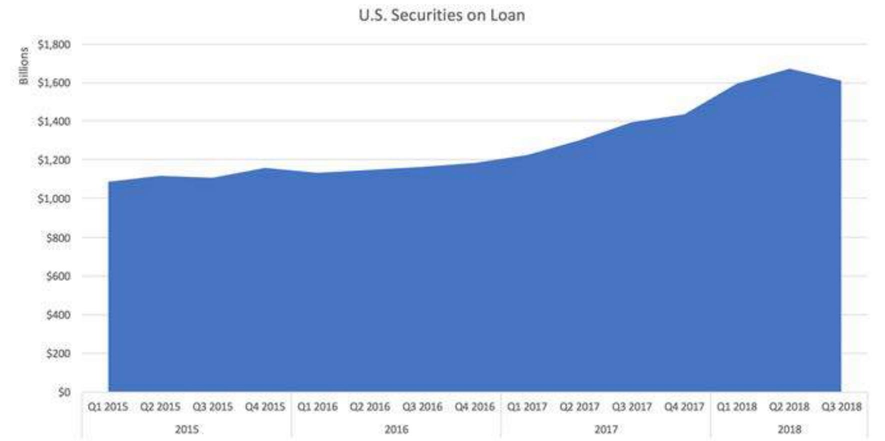


Figure two

Maybe Tesla is deemed too big to be rocked by these seemingly rocking events. Maybe some of them are prioritised differently by the cognoscenti in terms of risk and reputational impact. In the case of the resigning CFO, aggregate amounts remained fairly stable but there were a few big or bigger loans; similarly, for the smoking weed issue. For the abandonment of the re-privatisation plan, there seemed to be a delay while it sank in and then some activity occurred, but not on the day itself—maybe he was not believed. Maybe the next day's reaction was for something else. Just as market impacts of tweeted China tariff plans have lessened over time with each new tweet, maybe our market's participants are now assuming that there will be a slew of weird happenings at Tesla and that this is the new normal. However, by analysing each reaction or non-reaction and the timings thereof, it could someday become a predictive or foreshadowing tool.

Hence, 'The Minority Report' similarity—when rates are predicted, re-rates can be pre-planned and a day's extra income or saving picked up automatically across the board. Some tools already exist for efficient and effective allocation, but there are still certain aspects of the securities lending world that remain firmly in the hands of the humans—and long may it be thus.

However, the tools are coming that will enable participants to concentrate on the analysis of the suggested actions rather than finding those actions in the first place. Watch this space. **SLT**

Some tools already exist for efficient and effective allocation, but there are still certain aspects of the securities lending world that remain firmly in the hands of the humans

Tim Smith
Astec Analytics
FIS Global

Optimising securities lending in dynamic times

A close relationship between lenders and agents remains the focal point of a successful securities lending programme in today's ever-changing environment. Mary Jane Schuessler from RBC Investor & Treasury Services elaborates

Changing demand landscape

The regulatory focus on liquidity coverage following the financial crisis has increased demand for high-quality liquid assets (HQLA), effectively switching the majority of securities lending balances from equity to fixed income. As the demand for HQLA increases, a growing proportion of revenue is generated by fixed income loans, which tend to provide a relatively stable revenue stream. This stability is proving attractive to both new and existing lenders, who are looking for opportunities to drive incremental alpha on their idle assets.

In addition, interest in structured lending opportunities, including term loans, is on the rise. While borrowers are seeking HQLA, they are also looking for defined loan periods and willing to pay premium fees. Collateral flexibility is essential in these situations and the acceptance of lower-grade collateral, such as equity, is generally required in order for beneficial owners to optimise the benefits of term loans.

Despite changing demand dynamics, equities remain a significant component of on-loan balances. Demand for general collateral persists and the returns from specials continue to make a significant contribution to the revenue profile of a balanced asset mix. In Canada, for example, the cannabis sector has played a prominent role in the warm and hot space during the lead up to cannabis legalisation, which is scheduled for 17 October.

Collateral flexibility

As the borrower community looks to allocate their collateral balances where it makes the most economic sense, conversations between agent lenders and beneficial owners around collateral flexibility have become increasingly important and more frequent. Wider collateral acceptance can lead to higher lending volumes and premiums on structured term lending opportunities. However, decisions to expand the collateral matrix are largely dependent on a beneficial owner's risk appetite. Striking the right balance between risk and collateral acceptance is key to optimising a securities lending programme.

Regulatory constraints may limit the ability of a lender to accept certain types of collateral. Efforts are underway by industry organisations such as the Canadian Securities Lending Association and the US-based Risk Management Association to level the regulatory playing field and provide beneficial owners with greater collateral flexibility. As borrowers continue to demand wider collateral profiles, these industry initiatives will take on even greater importance, providing potential to increase the attractiveness of a beneficial owner's portfolio.

Understanding the risks and maintaining oversight

Securities lending is not a 'one size fits all' scenario. As beneficial owners tailor their programme, it is important that they have a comprehensive understanding of the inherent risks and how agent lenders can help. This requires a close working relationship between both parties and providing the agent lender with a good understanding of the beneficial owner's risk tolerance is key. While the conversation around demand drivers and collateral options has shifted in recent years, the risk discussion remains at the forefront.

In addition, topics such as data visualisation, agile thinking and robotic process automation have recently surfaced within many facets of the financial services industry, including the securities finance sector. Initiatives in these areas are expected to take on increasing prominence as they offer beneficial owners the potential for increased transparency and the ability to take a regular pulse on their lending activity.

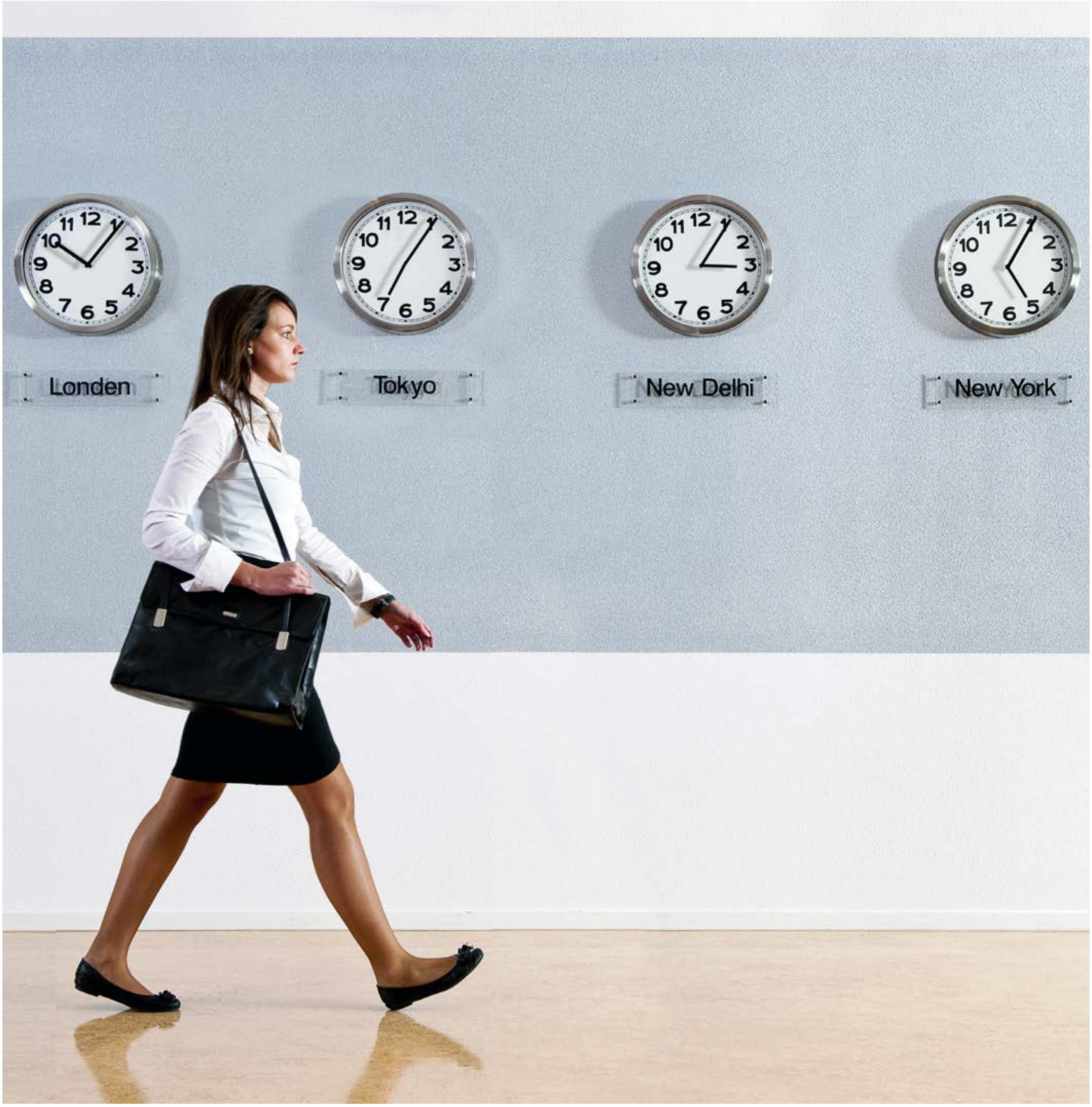
Engaging with agent lenders

It is important for beneficial owners and their agents to spend time together reviewing programme objectives, discussing the inherent risks based on the lender's risk tolerance and sharing information on lending performance. Such ongoing engagement provides lenders with the comfort that their portfolios are being optimised in line with the agreed risk appetite. It also enables agent lenders to balance the changes in beneficial owners' investment portfolios with evolving requirements of the borrowing community.

> ***It is important for beneficial owners and their agents to spend time together reviewing programme objectives, discussing the inherent risks based on the lender's risk tolerance and sharing information on lending performance***

While ongoing discussions around risk management and performance tracking are essential, the conversation also needs to cover the impact of changing regulatory regimes on lending activities. An important role for agent lenders is to work with the various industry and regulatory bodies on behalf of both the beneficial owner and borrower communities, which often share common goals.

The securities lending market continues to evolve largely based on a changing demand landscape, which is driving calls for increased collateral flexibility through regulatory change. As these discussions progress, the close working relationship between beneficial owners and agents will be even more important. **SLT**



This woman's work

The financial services industry suffers underrepresentation of women in its senior roles, but there is progress to solve this and ongoing improvements for equality

Jenna Lomax reports

Less than one in five of C-suite positions are held by women in the financial services industry, according to a McKinsey & Company report, entitled: 'Closing the gap: Leadership perspectives on promoting women in financial services'.

Early in their tenure, women are 24 percent less likely to attain their first promotion than their male peers, even though they request promotions at similar rates. Over half of the senior women surveyed—those who have reached the level of vice president or above—believe they have missed out on opportunities because of their gender, compared to just 10 percent of their male peers.

The survey found women of colour are particularly disadvantaged: they are 34 percent less likely to make their first promotion than men in financial services.

Asheet Mehta, global co-leader of McKinsey's global banking practice, says: "Our research has shown that tackling gender parity in the financial services industry yields dividends—in terms of the bottom line and other performance measures, and in retaining and attracting talent."

She adds: "Making progress on this issue will require corporate leaders—both male and female—to view gender equality as a strategic priority, and one that is integrated into the organisation's day-to-day work."

With this in mind, how do we close the gap without creating another type of inequality and a new debate on bias? How can we increase diversity, yet still genuinely pick the right person for the job, based purely on merit and experience?

Representation: girls just wanna have equal opportunities

Securities lending is of course a very niche part of the market, under the securities finance umbrella—and a part of the market not many people on the street would necessarily be aware of. Many think diversity within this niche part of securities services should be increased and it is showing signs of improvement.

As Fiona Mitchell, senior securities lending sales and relationship manager at Northern Trust, reflects: "Securities lending is a specialised area [...] it's tough in terms of levelling the playing field, but it's encouraging to see the industry's attention on this issue."

Natalie Float, head of market and financing services for Asia-Pacific, BNP Paribas Securities Services, says the initiative is not to push aside men at all.

As Float articulates: "BNP Paribas has a number of women in senior or key positions and it's not by accident or gender construct—the bank simply looks for the best fit and has both a senior management team who are confident enough to build the best teams looking at a broad range of skills, without bias, and creates an environment where women have the confidence to step into these roles."

Importantly, she adds: "Equality is broader than gender—the bank considers diversity from all angles be it gender, age or nationality, etc–we aim to construct the best team for our clients."

"I don't support the idea of receiving a role because of my gender [...] otherwise we could create another type of inequality and a new discussion on bias. Taking on a new role is about potential—the person making the decision is looking at prior experience but also projecting ahead for potential."

Many institutions are actively taking steps to bring about change in gender equality, but also ethnicity and nationality too.

Simone Broadfield, head of agency securities lending, APAC at BNP Paribas, says: "Efforts around diversity and equality have definitely improved in recent years. We need to continue to build on some of the good initiatives already in place to ensure momentum is not lost."

She adds: "There is also always the risk of being accused of positive discrimination due to quota targets and hiring policies, but you do need to start somewhere."

Where to begin

Just as children start their general education early in life, there's no better place to start than the beginning in terms of educating young girls and giving them insights and opportunities into the world of finance.

Mitchell says: "Through working with schools, universities and engaging in mentoring programmes across our businesses, we can help women take advantage of the opportunities that exist."

She adds: "One of our biggest priorities is to make sure that we build a pipeline of women in junior and entry level roles, whilst supporting women through their careers so that they can progress into more senior positions."

As women progress in their careers, talent, leadership and mentoring programmes can, where appropriate, yield excellent results in addressing attrition rates, according to Broadfield.

She says: "Some obvious points would be to increase the engagement of approachable senior females with junior staff, ensure that remuneration is fair and aligned with male peers, as well as ensuring that adequate support is given at pivotal points in women's lives and careers via fair maternity policies, flexible work policies where possible, and the operation of return to work schemes."

"There are some roles in my opinion, for example trading, to which some policies are difficult to apply and for those roles it becomes a personal career choice."

Securities lending top priorities

How can the aforementioned efforts towards more inclusivity help current obstacles and challenges the industry is currently facing?

Mitchell advocates "businesses with greater gender diversity perform better and are more profitable".

"This is also true for companies with greater ethnic and cultural diversity and it is encouraging to see that there are a number of initiatives that are directly addressing this at Northern Trust."

As the securities lending industry grapples with regulation—especially the looming Securities Financing Transaction Regulation (SFTR), as well as technology disruptors and opportunities, it seems like the perfect time to collaborate, innovate and search for the best talent from every background.

Farhat-Dupla, head of securities finance product management at Murex, states: "As the market continues to evolve quickly, trading desks are being consolidated, the regulatory burden is increasing, and technology is becoming more advanced."

Float says: "As we all have roles in global banks and have global clients, we need to be advocates for our markets and activities."

"For example, if you take China—all of our clients around the world want to be ready and invested, but they need to know that they cannot only enter but also exit the market, and what the tax implications are."

"This level of detail—going beyond the headlines—is a challenge and somewhere we can add the most value for our clients."

Current efforts and initiatives

Of course levels of diversity can vary from region to region and can be dependant on the job level. For example, a company could be praised for the amount of diversity it shows in its junior roles, but the senior level may be glossed over, or vice versa.

Broadfield says: "Broadly speaking, [in] securities lending representation of females is typically strong at a junior level and begins to wane significantly at a more senior level due to choices that women often have to make at pivotal moments in their career. This does of course vary region to region and is also heavily dependent upon the corporate culture at the companies who are active within our industry."

But she adds: "I am proud to say that the corporate culture at BNP Paribas Securities Services is refreshingly positive with a clear and genuine focus from senior management as to the identification and retention of female talent."

"Within securities services we can state that we have female representation at a junior to senior level, across all securities lending product functions in every region globally."

The Nordic region is advanced in terms of its establishment of a strong gender balance, according to Mitchell. She says: "I see opportunities for organisations to follow their clear example."

In addition, Northern Trust has signed up to the Women in Finance Charter which has set a target to increase the number of women in senior management roles in the UK to 35 percent by December 2020 and, according to Mitchell, the company is well placed to achieve this.

Northern Trust is also a corporate member of the London Women's Forum, a network for senior female leaders in London's financial services.

She adds: "At Northern Trust I am co-chair of the Women in Leadership Committee in London—a global group that aims to support women in our organisation."

"Women who are already in the industry have a crucial role to play by mentoring and reaching out through their own networks to encourage new talent, however it's also incumbent on all of us to take the lead in driving change and ensuring we have a diverse and inclusive work environment."

Murex actively supports Teen-Turn in Ireland and All Girls Code in Lebanon, inspiring girls to get involved in technology from an early age.

Farhat-Dupla states: "We encourage diversity and are actively supportive of some great initiatives."

Looking to the future, Farhat-Dupla says: "The number of women working in securities lending is low, but I am hopeful for the future."

She adds, that the capital markets are "a dynamic and exciting place to work, particularly from a software perspective".

"We need to show ambitious girls that when it comes to capital markets careers, the sky's the limit."

Mitchell concludes: "I strongly believe if we continue to develop these [aforementioned] networks and support these initiatives, making sure there are policies in place to support women, we will start to see genuine change." **SLT**

Regulation is driving opportunities

James Day of BNY Mellon gives an agent lender's perspective on the future of the securities finance market in Europe

Maddie Saghir reports

What are agent lenders doing to remain competitive, relevant and profitable in the future of the securities finance market?

In order for agent lenders to remain competitive, it is important that they fully understand the landscape and the challenges that clients, beneficial owners, and borrowers are facing, as well as the opportunities.

Clients may have a number of challenges, particularly with some of the regulations that are out there. We also have a lot of clients that are coming to us and looking at how they can solve for the non-cleared margin rules. Therefore, we are engaging with them and building our solution set accordingly.

We are constantly looking to introduce new assets into the programme that can enable our clients to generate additional revenue by meeting borrower demands.

From a yield perspective, it's about optimising our current book and making sure that we are extracting the most revenue for our clients. We are also focused on market rates and making sure that we are keeping assets out on loan when rates are coming down.

Another area of focus is creating efficiencies that help clients extract revenue from their supply. There are a couple of new examples of market access and one of those is around central counterparties (CCPs) and pledge models. The other is the continued focus on automation amid an increasing pressure to do more with less. Real-time reconciliation of pending and settled loans is one example of how we are creating efficiencies across the whole lifecycle of the lending transaction.

How have new regulations impacted your business and what are you doing to alleviate these issues?

Regulation is driving opportunities across the marketplace. The introduction of the non-cleared margin rules, for example, is causing participants to look at securities lending and securities finance to meet their collateral and margining requirements.

Meanwhile, the Basel III capital, liquidity and balance sheet rules have created opportunities for beneficial owners to earn an increased premium for lending via these new structures. We have also seen evergreen term structures that address some of the liquidity issues where lenders are lending out their assets on term and they are generating a premium for doing so.

Another area that we are focusing on is accepting collateral under a pledge mechanism using an English law securities interest arrangement in a pool participant model. This is in order to enable our clients to participate and lend through a pledge of collateral to receive a premium on those loans.

We are also looking at CCP models to reduce the capital required to support borrowers and therefore give our clients the ability to earn a premium on the loan rate.

How are you adapting to offer fresh value-added services to existing and new beneficial owner clients?

The conversations that we are having with clients are really evolving as they look for various solutions to help them navigate the complexity out there. It's all about helping clients unlock the liquidity that's inherent within their portfolios, and extracting the intrinsic value from their assets for them.

The conversations that we are having with them are about how to transform their assets into an acceptable form of collateral: how they can raise cash from their assets, how they can invest any excess cash they have in their portfolios, and how they are hedging their currency exposure.

What can beneficial owners do to enhance revenue for both the buy- and sell-side?

They can increase flexibility for clients by introducing new assets into the programme and by investigating the use of CCPs and pledge models.

Capital liquidity and the balance sheet are in focus, so clients that have a flexible collateral profile will accept a broad range of assets and are able to generate and sustain the revenue of their assets.

As the constraints across the market change, it is that flexibility that will enable clients to meet the demands, depending on what the flexibilities are, and continue to earn revenue from their lending programmes. **SLT**

"In order for agent lenders to remain competitive, it is important that they fully understand the landscape and the challenges that clients, beneficial owners, and borrowers are facing"

James Day
Managing director and business executive for securities finance for EMEA
BNY Mellon

US equity 'specials' demand falls

Most expensive to borrow US equities have delivered alpha in September, but demand is still down, says Samuel Pierson of IHS Markit

- Most expensive to borrow have underperformed by 170 basis points (bps) in August
- US equity borrow balances with fees greater than 500bps down 34 percent since 2016
- Proliferation of low balance specials leads to a record number of specials
- Tesla bolsters 'warm' balances back to 2016 peak

In a year which has generally been regarded as one big short squeeze, it's unsurprising that demand for the most expensive to borrow equities has been declining. The traditional short interest metric, which looks at the percentage of outstanding shares short, has delivered negative alpha this year, with the most shorted stocks outperforming the least shorted by 85bps per month, which doesn't even consider borrowing cost.

On the topic of borrow fees, the most expensive to borrow metric has actually fared better than other short interest related factors in 2018. September is on pace to be the fifth consecutive month of positive returns per IHS Markit Research Signals quant research platform, with the most expensive to borrow stocks underperforming the rest of US equities by more than 170bps month to date. That does not include borrowing fees, however, the average borrow fee for the most expensive to borrow group is currently 11 percent annualised, or 90bps per month, suggesting there has been alpha in the most expensive to borrow stocks in September, net of borrow fees.

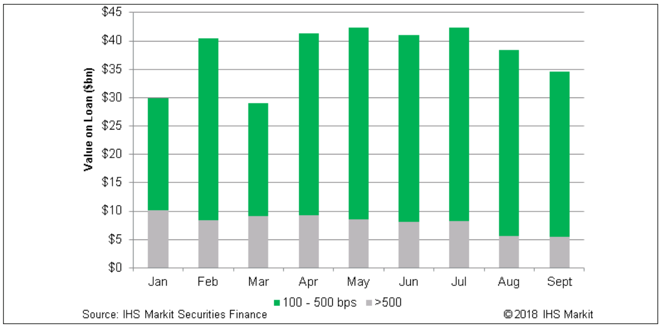
The declining demand for specials this year has extended a trend in place since 2016 when the Q2 rally jolted short sellers who added to positions in the energy-related sell-off in Q1. January 2016 was the best month for the most expensive to borrow factor post-crisis, followed shortly thereafter by April of that year turning in the worst post-crisis returns, and both records still stand.

The 'specials' balances in latter 2016 were aided by Tesla trading special around the SolarCity acquisition, which peaked on 23 September, with borrow fees north of 27 percent on a balance of $5.4 billion (the marginal rate for new borrows was 70 percent that day). While Tesla no longer trades special—minor shocks around proxy votes earlier this year notwithstanding—the fee has stayed above 100bps since April, bolstering the 'warm' balances in the 100 to 500bps range.

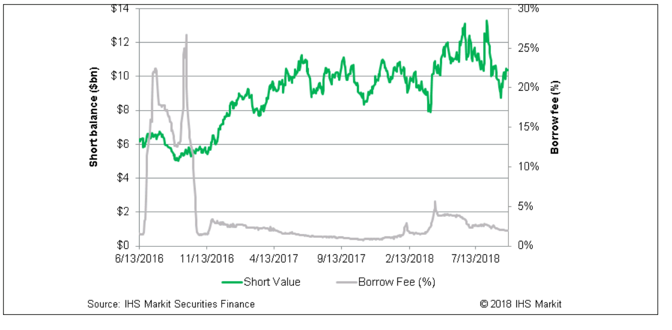
The significance of Tesla to demand 'warm' stocks is notable, with balances in January and February much lower than March of this year, purely as the result of the Tesla balance being below the threshold. A similar story emerges for 2017, which had a TSLA-sized hole for warm balances. It's worth noting that TSLA balances have only briefly touched a balance lower than $8 billion since the borrow fee started to decline in early 2017.

Whether the recent alpha delivered by shorting the most expensive to borrow stocks leads to an increase in demand for specials remains to be seen. A further potential tailwind for specials demand is that October has historically been a strong month for returns to shorting the most expensive to borrow stocks. The most expensive to borrow US equities returned 4.9 percent less than the least expensive to borrow stocks in October 2017, which followed an even stronger October 2016, when the most expensive to borrow stocks underperformed by 5.5 percent. Amid a challenging year for short sellers, seeing the most expensive borrows in the short book deliver alpha, net of borrow cost, is certainly welcomed for as long as it lasts. **SLT**

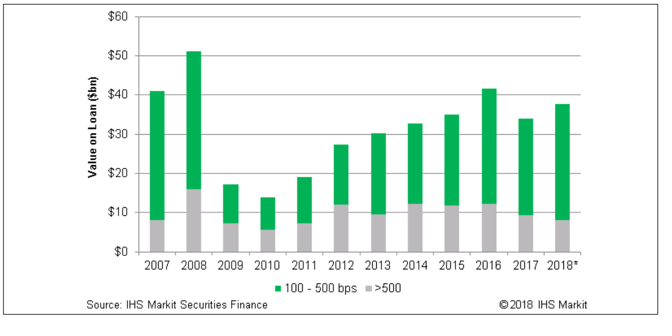
2018 US Equity Special Balences

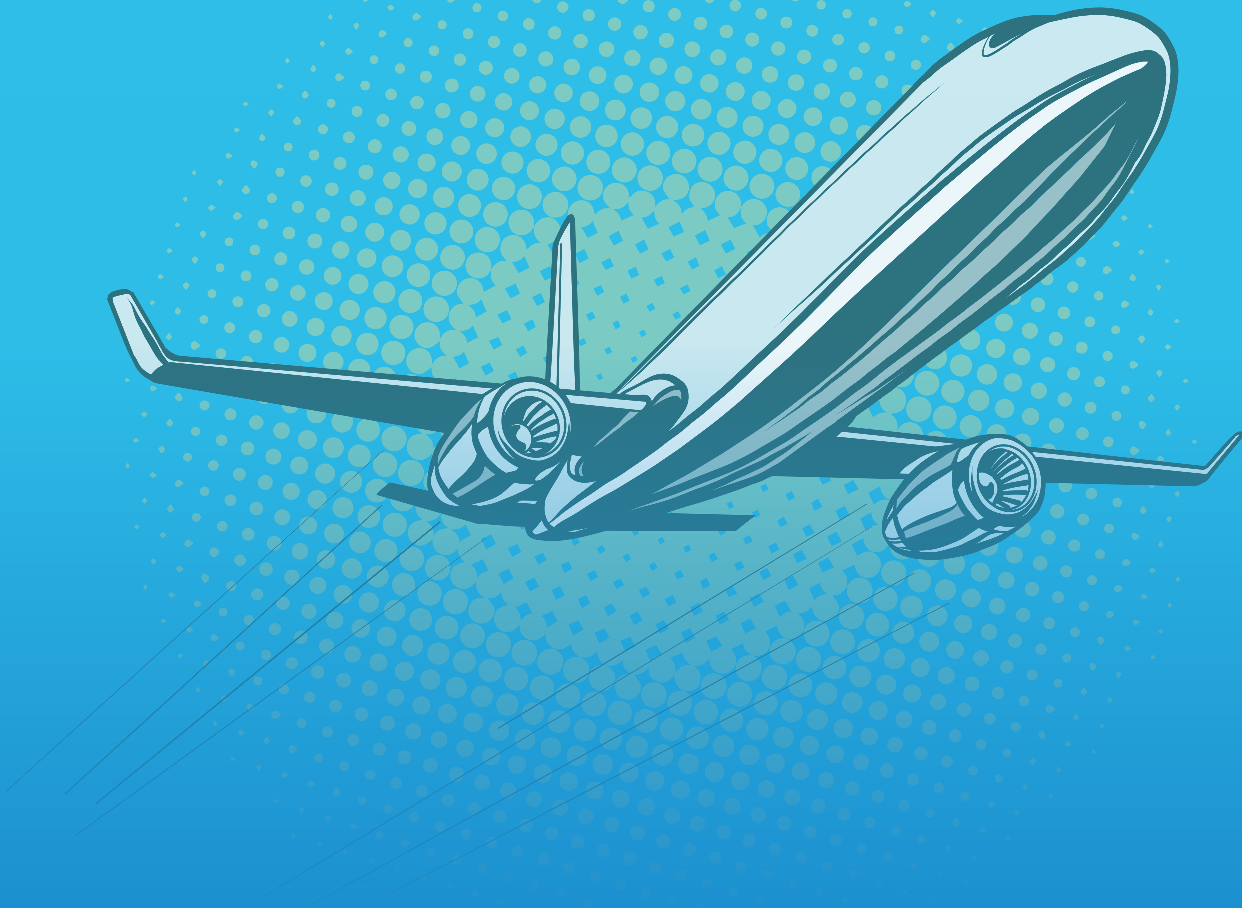


Tesla Inc short balance and borrow fee



US Equity Special Balances





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Amsterdam

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11-12

https://bit.ly/2vv3X6i

Comings and goings at LCH, BNP Paribas, Mirae Asset and more

LCH has appointed Kate Birchall as head of Asia Pacific, effective from 15 October.

Based in Sydney, Birchall will report to CEO Martin Pluves and will be responsible for LCH's business in the Asia Pacific (APAC) region, including the central counterparties existing over-the-counter derivatives clearing operations in Sydney and Tokyo.

Birchall will join LCH from National Australia Bank (NAB), where she was most recently head of portfolio optimisation and collateral.

Prior to her time at NAB, Birchall was a director at KPMG and has also held various roles at Lloyds, CIBC and Australia and New Zealand Banking Group.

Birchall takes over from Marcus Robinson who has been appointed as head of group business development at LCH, based in London.

In his new role, Robinson will be responsible for defining new business opportunities by engaging clients across services to identify and develop new services and products. Robinson will report to Daniel Maguire, CEO of LCH Group.

Pluves said: "In her new role, [Kate Birchall] will oversee our growing business in APAC, fostering relationships with market participants in the region, and leading our colleagues based in Australia and Japan."

"I'd also like to thank Marcus Robinson for his successful four-year tenure as head of APAC, and look forward to continuing to work with him in his new role as head of group business development."

Simon Mogg has left the agency lending desk at BNP securities services.

Mogg has been a trader at the company since January 2016.

He was previously a sales trader/desk analyst at Tejas Securities from 2011 to 2013.

Before that Mogg worked as a sales trader/desk analyst at Elevation LLC.

It has been confirmed that Pete Volino has left Mirae Asset, the New York-based financial firm.

Volino was head of global equities for two years, and prior to that was managing director for equities at Industrial and Commercial Bank of China Financial Services from 2011 to 2016.

He also served as managing director at Cantor Fitzgerald from 2003 to 2010.

It has also been confirmed that Rob Cleary has left the firm.

The Goldman Sachs Group has made a number of senior level changes.

John Waldron will become the firm's president and COO, effective 1 October.

Waldron joined Goldman Sachs in 2000 and has been responsible for sustaining and enhancing Goldman Sach's global position in underwriting and mergers and acquisitions since being named co-head of the investment banking division (IBD) in 2014.

Waldron previously served as global head of investment banking services/client coverage for IBD.

Before that, he was London-based global co-head of the financial sponsors group from 2007 to 2009.

Stephen Scherr has been appointed CFO, effective from 5 November after the filing of Goldman Sach's Q3 results.

Scherr has served as CEO of Goldman Sachs Bank USA since 2016 and is also head of its consumer and commercial banking division.

He joined Goldman Sachs in 1993 as an associate in the financial institutions group.

Martin Chavez will become vice chairman of the firm and co-head of the securities division with Ashok Varadhan and Jim Esposito.

Chavez, CFO since 2017 first joined Goldman Sachs in 1993 in the J Aron currency and commodities division.

The senior changes follow current CEO Lloyd Blankfein's decision to step down, which was announced in July. He will be replaced by David Solomon after 12 years in the role.

Solomon, said: "John Waldron and Stephen Scherr will work closely with me to develop and execute our strategy, grow our client franchise, ensure strong risk and capital management and safeguard our unique culture."

"I have worked with Waldron and Scherr for nearly two decades and am confident that they bring the right complement of skills to help lead the firm through their respective roles."

GLMX Europe has appointed Robert Miles as head of operations, Europe, as part of its continued expansion.

Miles will be based in London and will join Phil Buck, who was recently hired as managing director of GLMX Europe.

Previously, Miles served as technical operations manager at trueEx Group.

GLMX CEO and co-founder Glenn Havlicek, commented: "Robert Miles's experience strikes a unique balance of a strong background in building capital-markets-focused technology with an in-depth understanding of the workflows resident in the repo and securities lending markets."

Broadridge Financial Solutions has revealed that Tim Gokey, the company's president and COO, will become the new CEO.

In addition, Rich Daly, the current CEO, has been appointed as the new executive chairman of the board, while Les Brun, Broadridge's independent chairman of the board, will become the lead independent director. All moves will be effective 2 January 2019.

Gokey joined Broadridge in 2010 to lead the company's growth initiatives. He was named COO in 2012 and president in August last year.

Commenting on the appointment, Brun said: "On behalf of the board, I am pleased to announce that, as part of a long-planned and well-orchestrated succession process, Tim Gokey will become the next CEO of Broadridge."

He added: "Gokey has been instrumental in creating and executing strategies that have driven significant growth for Broadridge over the past eight years, and he is the right person to lead Broadridge into the future."

"I am also pleased that Rich Daly will remain actively involved as executive chairman."

"Daly founded our investor communications business and has been CEO since Broadridge became an independent company in 2007. We're fortunate to be able to continue to benefit from his deep knowledge and passion."

Daly also commented: "Gokey is one of the most committed and capable leaders in fintech. He has a proven track record and has been an invaluable partner as together we have transformed Broadridge into a leading global fintech company."

Gokey stated: "I am both humbled and excited to lead Broadridge on its next stage of growth."

He added: "I am also honoured to be succeeding Daly and delighted that he will remain at Broadridge as executive chairman."

"In his new role, Daly will lead the board and support several important regulatory initiatives for which he has enormous passion, including digital and retail investor engagement." **SLT**

If you have an industry appointment we should cover?

Contact us at:
beckybutcher@blackknightmedialtd.com