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Issue 234 20 August 2019

Innovation Insight

The industry has been presented with a digital smorgasbord of new technological tools, but what to choose?

UMR Update | Technology Insight | Data analysis from FIS | Latest people moves

Pierpoint's recruitment drive continues with Arnesen hire

Pierpoint Financial Consulting has brought on former global head of securities lending at BNP Paribas Securities Services, John Arnesen, to oversee its consulting operations.

The boutique consultancy was launched by Roy Zimmerhansl, former HSBC global head of securities lending, in January with a focus on securities finance and collateral management.

The firm aims to leverage the significant experience of its team to provide independent advisory services to a broad range of market participants including buy-side, sell-side and vendors.

Pierpoint is currently working with a number of firms including RFPS, formerly Karson, on a project for a new asset for repo, securities lending and derivatives set to be unveiled later this year.

Arnesen brings 28 years of securities finance experience, including his most recent role at BNP Paribas, which he held between 2011 and February 2019.

He also served as managing director and head of securities lending for Europe, the Middle East and Africa for BNY Mellon from 1998 to 2008.

Zimmerhansl said: "I have worked with John as an innovative counterparty and battled against him as a formidable competitor. He brings complementary skills, perspective and client contacts to our business and adds tremendous value to the Pierpoint client offering."

Arnesen's appointment follows closely after that of Andrew Howieson, who joined as research partner last week. Howieson also boasts a pedigree in his field with more than 30 years' experience in global capital markets, including his time as head of global corporate strategy and business development for State Street.

Howieson's securities lending experience includes his tenure as eSecLending's European managing director for global securities lending between 2005 and 2007. He has also worked as a consultant for institutional investors and co-authored several white papers focused on potential developments for the securities lending market.

Commenting on Howieson's new role, Zimmerhansl said: "Information and understanding are key pillars of the Pierpoint client proposition and Andrew has brought clients deep insight on securities lending and market liquidity throughout his career."

Pierpoint Financial Consulting's recruitment drive initially began with Andrew Stephenson, who joined as practice manager last month. Stephenson brings 15 years of consulting as a tax attorney as part of the executive team of a leading global practice and running a specialist practice delivering a range of services to asset owners, asset managers and global custodians.

Zimmerhansl said that with these latest hires taking charge of the consulting and research pillars of Piermont's offering, the firm is now setting its sights on stripping back the layer of complexity that shrouds securities financing for those not immersed in the industry on a day-to-day basis. In doing so he hopes to bring greater understanding to new market entrants and offer impartial advice to improve the strategies of existing market participants.

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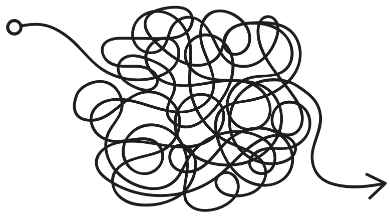
Published by Black Knight Media Ltd

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ISLA welcomes EBA's haircut suggestion

The International Securities Lending Association has hailed the European Banking Authority's (EBA's) suggestion to withhold the introduction of minimum haircut floors for securities financing transactions (SFTs) from the bank capital requirements framework.

According to the EBA, more data is needed to assess the impact of introducing minimum haircut floors in the EU.

The authority has argued that such a thorough data analysis might only be performed once the Securities Financing Transactions Regulation's reporting regime is fully implemented in 2021.

The EBA also believes that minimum haircut floors for SFTs should be introduced through market legislation rather than banking legislation.

This policy idea was first put forward by the Financial Stability Board in 2015 and was included in the December 2017 agreement on a new set of Basel Committee bank capital rules.

ESMA seeks experts in data regulatory reporting

The European Securities and Markets Authority (ESMA) has issued a call for candidates for its newly-established data advisory group (DAG). ESMA is seeking individuals with expertise in market data, regulatory reporting and record-keeping of derivative contracts positions.

A knowledge of transactions in financial instruments, including securities financing, is also required.

The authority is also looking for individuals with aknowledge of order book, instrument reference data, investment funds and prospectus data.

DAG members will advise ESMA's data standing committee (DSC) which undertakes ESMA's policy work in data and reporting related areas.

Once established, the new group aims to assist DSC on specific data matters in its work on the completion of a single rulebook and advise where necessary on specific data matters in its work related to the development of supervisory convergence tools.

DAG will also inform the committee on matters of practical implementation of reporting requirements which require clarifications or adaptations.

Interested individuals should send their candidacy to ESMA by 16 September 2019.

BrokerTec sees repo increases

CME Group's BrokerTec saw increases in repo average daily notional volume in both the US and Europe for July.

US repo average daily notional volume increased 18 percent to $261 billion last month, while European repo average daily notional volume increased 5 percent to €263 billion.

BrokerTec said that its fixed income trading included an increase in US treasury daily notional volume, which grew by 21 percent to $152 billion.

Meanwhile, CME Group posted an average daily volume of 16.6 million contracts during July, up 23 percent from the same period in 2018.

Open interest at the end of July was 139 million contracts, up 20 percent from year-end 2018 and up 15 percent from July 2018.

Broadridge reveals fiscal year results

Broadridge revealed that its Q4 fiscal year total revenues decreased by 8 percent to $1.2 billion from $1.3 billion, compared to 2018.

Of its 2019 results, Broadridge said: "Considering the impact of the ASC 606 revenue accounting change, total revenues would have increased $13 million, or 1 percent."

Broadridge's results also showed that recurring fee revenues for Q4 2019

Barclays eyes Deutsche Bank's PB business

Barclays is set to gain a share from Deutsche Bank's prime brokerage business, sources have confirmed.

This follows an announcement from Deutsche Bank's CEO, which indicated negotiations are on track for the sale of Deutsche Bank's prime finance and electronic equities platform to BNP Paribas.

The sell-off is part of Deutsche Bank's move to exit the equities sales and trading business, while retaining a focused equity capital markets operation, as part of a radical transformation.

Meanwhile, it was recently reported that Barclay's balances in prime financing grew by some $20 billion over the last month.

Jes Staley, Barclays Group CEO, commented: "It's a very attractive business. It's an interest accrual business, you earn revenue on Saturdays and Sundays, and so it's a very important part of one's overall markets business and we have a very strong franchise in prime brokerage, and we look forward to growing it in the future."

Deutsche Bank declined to comment on the latest acquisition activity.

decreased 6 percent to $813 million from $862 million.

Operating income was reported at $241 million, a decrease of $25 million (10 percent).

Total revenues for the fiscal year ended 30 June 2019 increased 1 percent to $4.4 billion from $4.3 billion in the prior-year period.

Recurring fee revenues for the 2019 fiscal year increased 6 percent to $2.8 billion from $2.6 billion.

Broadridge explained that the strengthening of the US dollar against other currencies negatively impacted revenues by $25 million.

Additionally, the results showed that Broadridge completed three acquisitions with an aggregate purchase price of $406 million.

One of these acquisitions included Rockall Technologies, which expands Broadridge's core front-to-back office wealth capabilities.

Broadridge said the addition of Rockall Technologies, provides securities-based lending and collateral management technology solutions to help firms manage risk and optimise clients' securities lending and financing needs.

Tim Gokey, Broadridge president and CEO, commented: "The fiscal year 2019 was a strong year as we generated double-digit EPS growth and executed against our strategic goals. Broadridge achieved 6 percent recurring fee revenue growth and 11 percent adjusted earnings per share growth. We also closed out the year on a very positive note as a strong fourth quarter powered another year of record closed sales, and we made three tuck-in acquisitions that will further strengthen our business."

ISLA responds to ESMA's SFTR consultation paper

The International Securities Lending Association (ISLA) has responded to the European Securities and Markets Authority (ESMA) guidelines for reporting under articles four and 12 of the Securities Financing Transactions Regulation (SFTR).

The International Capital Market Association and the Association for Financial Markets in Europe also contributed to the paper.

Together, they coordinated respective submissions and aligned findings, feedback priorities and issues for escalation.

In the introductory comments for the responses, ISLA noted that ESMA should pay attention to the potential restriction on the use of non-EU issuer legal entity identifiers (LEIs).




We clear the path

OCC has the largest centrally-cleared stock loan offering in the world with approximately $80 billion in cleared loan balances. Over the last 25 years, OCC has built an innovative and unique U.S. program for securities lending transactions where OCC steps in as the counterparty (with a two percent risk weight) and guarantees the return of stock or collateral. We continue to enhance and expand access to our stock loan program in order to offer clearing solutions and capital efficiencies for our members and the entire securities finance industry.

As the world's largest equity derivatives clearinghouse, OCC is committed to providing market participants with high quality and efficient clearing, settlement and risk management services. As a Systemically Important Financial Market Utility, we work to enhance our resiliency in order to reduce systemic risk, increase market transparency, and provide capital and collateral efficiencies for the U.S. capital markets.

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ISLA noted that "EU beneficial owners generally accept a diverse pool of collateral to reduce systemic risk, if the number of available securities is reduced; It may increase the risk profile of these businesses".

The restriction of non-EU LEI issuers would "impact financial stability by reducing overall market liquidity, creating market squeezes and a global wholesale market unwind via mass recalls. This will not just impact EU markets as all global capital markets will be impacted, particularly those with lower LEI adoption rates."

"The impact on liquidity will not just be on the securities with no LEIs but also the wider indexes which they form part of. It will reduce short covering in the market and restrict the ability of businesses to lend their pool of available assets."

Additionally, ISLA highlighted that it may lead to an inability to hedge positions creating wider spreads and higher costs, and damage the competitiveness of UCITS and alternative investment funds involved in securities lending and more generally reduce the return to EU-based pension funds.

ISLA added that the restriction may also potentially move businesses and their transactions to non-EU based locations.

Elsewhere in the responses, ESMA asked: "Which approach would you favour in terms of reporting cash-driven SLB?"

In response, ISLA said: "ISLA members are advising as best practice that companies should book the trades to the template that best fits and annotate the Master Agreement Type in the relevant field under which it is governed."

"So for 'reverse stock loans' which are essentially a structured finance trade with all the hallmarks of a repo, [for examaple] loan of cash etc, report them in the repo template but reference the securities lending agreement in field 2.9 as the trade agreement."

ISLA explained: "This was the conclusion, else these types of trades simply do not fit into the Stock Loan template as they are traditionally not the loan of stock (therefore cash)."

Meanwhile, as ESMA is set to publish their official responses to the consultation in Q4 this year, ISLA will focus on several key objectives and deliverables between now and SFTR's first go-live in 2020.

This will include further engagement with all its various streams, including tri-party and vendor working groups to progress relevant discussions and publish content.

In addition, ISLA will look to deliver best practice to members and broader industry stakeholders and direction on compliance with the reporting obligations through interpretation.

In due course, ISLA will publish a high-level road map that will outline these workstreams and deliverables.

Richard Colvill, ISLA's SFTR analyst, commented: "This will provide a clear implementation path that will combine much of the valuable work we have done so far, whilst ensuring that we start to link our SFTR work with other important areas such as corporate actions and broader collateral harmonisation issues."

OCC's securities lending on the up for July

OCC's securities lending central counterparty (CCP) activity was up 10.5 percent in new loans compared to July last year, with 114,818 transactions last month.

The clearinghouse's year-to-date stock loan activity decreased 2.1 percent from 2018 with 788,568 new loan transactions this year.

The average daily loan value at OCC in July was $73 trillion, a decrease of 14 percent compared to last July.

Total cleared contract volume in July reached 403,483,838 contracts, a 7.9 percent increase compared to last July, and the highest total volume for July in OCC's history.

OCC's year-to-date average daily cleared contract volume was 19,358,621 last month, down 5.8 percent compared to 2018's record-breaking pace.

Futures cleared by OCC reached 6,641,028 contracts in July, up 3.5 percent from July last year.

OCC's year to date average daily cleared futures volume is 304,897 contracts, 28.8 percent lower than 2018.

Meanwhile, for options, overall exchange-listed options volume reached 396,842,810 contracts in July, up 8 percent from 367,568,020 in 2018. Equity options volume reached a total of 357,634,292 contracts, a 7.3 percent increase from July 2018.

This includes cleared exchange-traded funds options volume of 128,752,294 contracts last month, a 2 percent increase compared to the July 2018 volume of 126,246,601 contracts.

Eurex Repo figures report upward trend

Eurex Repo saw an overall increase of almost 8 percent in average outstanding volume across all repo markets last month, in comparison to July 2018.

The general collateral pooling market saw an increase of 19.3 percent year-on-year for July reaching €42 billion in July 2019.

Eurex also reported the number of traded contracts reached 130 million up from 109.9 million in July 2018, an increase of over 18 percent.

Both European equity index derivatives and European interest rate derivatives saw increases with the former up by over 20 percent to 67.5 million traded contracts.

Trading in European interest rate derivatives saw an increase of over 30 percent from 30.7 million traded contracts in July last year to 40.3 million in July this year.

Deutsche Boerse to launch CSDR solution

Deutsche Boerse Group is making plans to launch a solution for the challenges posed by the Central Securities Depositories Regulation (CSDR).

The Deutsche Boerse Buy-in Agent service will complete its existing offering for market participants to increase settlement efficiency, one of the key objectives of CSDR.

This includes automated securities lending or the provision of one single pool of liquidity that allows for efficient settlement and collateral management across central-bank money and commercial-bank money settlement environments.

In a statement on the solution, Deutsche Boerse noted that the regulation on settlement discipline for securities trading transactions obliges the buyer in a securities transaction to initiate a buy-in process against the seller should the settlement of a transaction fail after a certain period of time.

According to Deutsche Boerse, this requires a neutral third party who acts as a buy-in agent.

Therefore, the new service aims to close the gap and enable market participants to comply with the European regulation that will come into force in Q2 2020.

Additionally, the solution is set to provide a "high level" of standardisation and automation to resolve the operational burden, which is associated with the new mandatory buy-in process.

Erik Müller, Deutsche Boerse Group's global head of clearing, said: "Since buy-in agent services are essential for the CSDR implementation, we developed this service in close cooperation with the market and our regulators.

"We look forward to starting our service to best support our clients and the regulatory agenda."

A good haircut

On 2 August the European Banking Authority (EBA) declined to recommend minimum securities financing transactions (SFTs) haircut levels when it published a series of policy advice papers on Basel III related issues, including: 'On The Basel III Reforms On SFTs'.

As the European Commission noted in 2017 in its Securities Financing Transactions Regulation (SFTR) Article 29(3) report, the setting of minimum haircut levels was the only aspect of the Financial Stability Board's (FSB's) SFT recommendations that the EU's SFTR had not implemented. The commission stated that it preferred to first collate and analyse data from SFTR transaction reporting before setting these minimum haircut levels, thereby ensuring an empirical basis for legislation.

Haircuts are a percentage reduction in the value of collateral accepted in a loan to buffer the lender against a lowering of the market value of the collateral, without which he would be left partially uncollateralised.

The EBA's report is presented in the context of addressing Basel III counterparty credit risk associated with SFTs—the Capital Requirements Regulation and not SFTR. But its principal policy recommendation concerning haircuts directly affects SFTR and is worth setting out in full. The statement said: "The EBA shares the cautious stance taken by the European Securities and Markets Authority (ESMA) and the European Commission on the introduction of numerical haircut floors for SFTs, and recommends at this stage to withhold the implementation in the EU of the minimum haircut floors framework for SFTs in the capital framework as designed in the Basel III post-crisis reforms standards. In addition, if numerical haircut floors for SFTs were to be introduced in the EU, the EBA is of the view that this should occur via market regulation, but only after further analyses and recommendations are provided by market authorities and systemic risk authorities."

It would be inconceivable for the commission to adopt different sets of numerical haircuts under the Capital Requirements Regulation and SFTR—especially given the origin is the same FSB report—so this statement can be taken as an affirmation of the commission's aforementioned SFTR Article 29(3) view. The EBA also seems to be hinting that ESMA should be the agency that takes the lead.

I have always agreed with the commission's evidence-based approach and thus it would seem that minimum haircut levels will not transpire for another two years.

The calibration of minimum haircuts must be approached with sensitivity. If they are too high, not only will this adversely affect liquidity but equally, as the EBA astutely notes, this "could incentivise banks to enter into uncollateralised transactions whenever SFTs do not meet haircut floors. For example, in those cases where banks' counterparties are unwilling to accept a haircut on their securities".

This would lead to a situation where greater risk and leverage results from regulations designed to achieve the opposite.

The lay of the land is clearing. The EBA's report draws heavily on existing ESMA and commission Article 29(3) reports into SFTs. The commission, EBA and ESMA all believe in analysing the data. ESMA would propose to submit a report, prepared in a similar fashion to this one, once mandatory reported data of sufficient quality becomes available.

The European Systemic Risk Board is the outlier, believing in the current implementation. The former triumvirate approach will prevail and represents the intellectual approach of the EU on minimum haircuts.

Eventually, when the commission does adopt on the matter I do not expect any surprises. Levels are likely to be set below current market practice thereby allowing trading to continue uninhibited.

This would then be the final piece of the jigsaw that completes the EU's decade of the financial report following Lehman's collapse in 2008 and filing for Chapter 11 Bankruptcy.

On a final note, the High Court revealed in March this year that Lehman Brothers—the very bank whose collapse precipitated the financial crisis—is actually worth £7 billion pounds after all creditors have been repaid in full.

Seb Malik
Head of financial law
Market FinReg

Early Confirmed Beneficial Owners Attending Include:

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Director, Deputy Head, BCS Global Markets

Head of Treasury Services & Securities Lending Oversight., BMO Global Asset Management

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Head Trader, Public Markets, British Columbia Investment Mgmt Corp

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Portfolio Manager, Dimensional Fund Advisors

Portfolio Management Associate, Dimensional Fund Advisors

Senior Portfolio Manager, HSBC Global Asset Management

Portfolio Manager, HSBC Global Asset Management

Senior Fund Manager, Quantitative Equity Strategies, HSBC Global Asset Management

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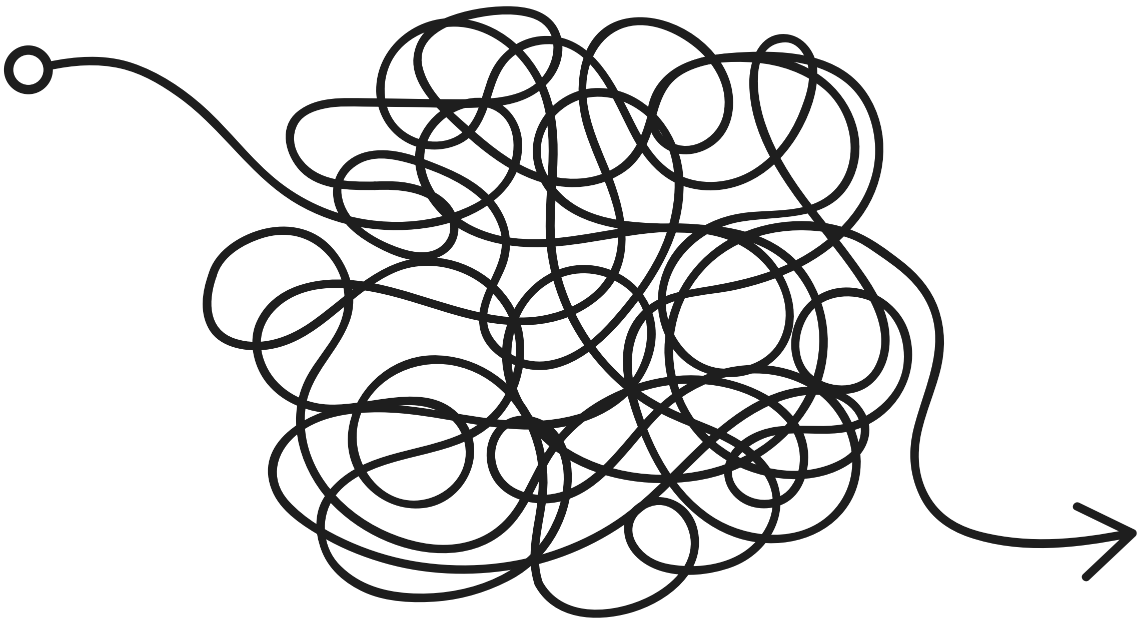


Creating a smooth path

Shaun Murray of Margin Reform explains how the fifth and sixth phases of uncleared magin rules will affect repo and securities lending

Maddie Saghir reports

How will the uncleared margin rules (UMR) phase five and six affect repo and securities lending?

From the buy-side point of view, this will be determined by whether the firm has access to collateral that is eligible for initial margin (IM) and whether that is agreeable to their counterpart during the IM negotiation.

For example, if they have a portfolio of treasuries, or other high-quality liquid assets (HQLA), there should be no issue. If they are using non-HQLA to post non-regulatory independent amount (IA) and these meet the eligibility criteria for regulatory IM, then this should be acceptable.

For those firms without this type of portfolio, there are a few choices:

Utilise repo and securities lending to switch or upgrade to collateral that is eligible in line with IM requirements.

Consider using cash products (money market fund) as eligible collateral, this could also form part of a collateral switch.

Negotiate with the dealers to widen the eligible collateral schedules to suit their requirements and utilise assets that they already hold.

Of course, as the cost pressures of IM becomes less palatable to individual organisations then optimisation will come to the fore as different techniques are used to balance the books.

One other indirect but related impact will be on Securities Financing Transactions Regulation (SFTR) and Central Securities Depository Regulation (CSDR) and the settlement of the two-way IM exchange.

How will UMR affect the trading of non-centrally cleared over-the-counter transactions?

The buy-side has been impacted by regulation far later than the sell side, and in that period trading derivatives has become more complex and the costs of trading have increased. It was expected that cleared versus uncleared would always see cleared as the cheapest and more viable option, the reality is that this is not always the case.

For products where clearing is not mandated, understanding the access your clearing broker has to different venues, plus the associated fees and costs should be compared to a bilateral trade, where you potentially post IM under Standard Initial Margin Model (SIMM) to a segregated account at a custody agent for the benefit of your potential insolvency. These form some part of the pre-trade analytics that could and should be performed.

Noting that, for non-centrally cleared, we have seen a market move to clearing in certain foreign exchange products such as non-deliverable forwards (NDF) which is in a large part attributable to the SIMM numbers. There are a couple of things to take away from this:

That costs have increased to a point where understanding how and where you can clear NDF's has become a higher priority on the to-do list.

That there is an increased focus on collateral and margining costs.

What UMR challenges are the buy-side facing?

The buy-side already post IA to the dealer community, sometimes this is segregated, sometimes not. Therefore, transitioning to regulatory IM should not mean a huge change to their balance sheets, however, the effort and complexity involved in getting ready for segregated two-way IM requirements are vast.

At Margin Reform we reference the 'Wheel of Pain' (see figure 1) and the nine key points to compliance. This commences with the stages of self-disclosure, client engagement, and regulatory understanding before you consider the legal documentation and custodial requirements.

Further, you have to understand whether your technology stack is fit-for-purpose and how you will deal with the multiple new operational processes which flow across the organisation such as pricing, IM risk sensitivity generation and post-trade, settlement and collateral management.

We have had different discussions and heard many different views on how firms can achieve compliance. Educationally, it feels like there is a way to go to get the requisite knowledge to a level where phases five (1 September 2020) and six (1 September 2021) will be as smooth as we would all like.

It has been suggested that the buy-side is focusing on the replacement of Libor and overlooking UMR's September 2020 deadline, do you agree?

Without a doubt, there is a huge amount of focus on the move away from Libor, and rightly so.

The results from the ISDA consultations are due to be published in Q3 alongside a new ISDA supplement and protocol, which is expected to become effective in Q1 2020, meaning transitioning away from Libor is likely to commence much earlier than the 2021 date referenced.

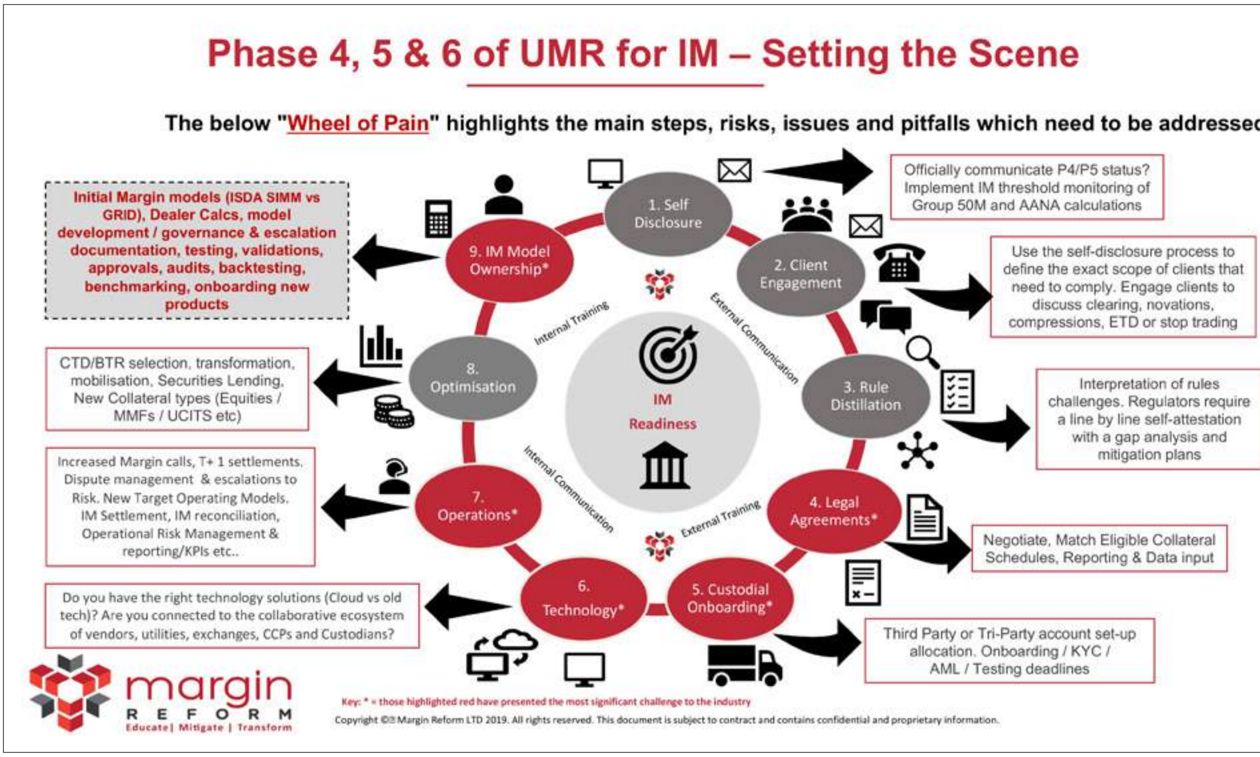


Figure 1

In a lot of firms, complex regulatory deliveries tend to utilise a number of the same people from business, technology, and change teams and with the effective date now accelerating, it is not a surprise that the conversations have gotten more focused to IBOR.

That being said, we believe there are a couple of areas, technology and legal documentation specifically, which with the right planning could benefit from a joint delivery.

What will the penalties of non-compliance with UMR phase five be?

Compliance isn't optional. There has been a huge amount of industry advocacy over the past six months to try and ease the compliance burden.

This led to a couple of statements from the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions. The upshot of the statement can be split into three points.

Legacy contracts: If amending legacy derivative contracts solely to address interest rate benchmark reforms, you are not required to apply margin requirements for UMR.

This position will need to be clarified under each relevant jurisdiction.

Acting diligently: In phase five (and now six) IM requirements will involve IM documentation, custodial and operational arrangements.

It was noted that if you are not going to exceed the framework's €50 million IM threshold, then you needn't be expected to complete all the documentation. However, as a covered entity, you are expected to act diligently.

Phase six: The final implementation phase for IM has been extended to 1 September 2021. Covered entities with an aggregate average notional amount (AANA) of non-centrally cleared derivatives greater than €8 billion will then be subject to the requirements.

The change to facilitate this extension is the introduction of an additional implementation phase on the 1 September 2020 (phase five), when covered entities with an AANA of non-centrally cleared derivatives greater than €50 billion will be subject to the requirements.

It is possible that we may see additional clarifications on the regulatory wording, for example, some questions have been raised about the European Markets Infrastructure Regulation Refit and IM model approval which remains a grey area.

A shot across the bows of non-compliance has already been given by the National Futures Association (NFA) and a fine issued.

It was found that inadequate processes and validation techniques had been used to assess the risks of the UMR margin model and that the necessary operational steps had not been taken to satisfy the initial margin and variation margin collection requirements.

What does the future of collateral management look like?

Collateral management should be regarded as a horizontal across any organisation. Collateral is a product in its own right, whether it's the repo and securities finance market or the derivatives, futures and cash markets.

At every point, if you consider all of the pre-trade elections that are now possible and in a lot of instances required before execution, you realise that these are all inextricably linked to the post-trade impacts on treasury, optimisation, and liquidity and this is before you get to the additional operational and risk complexity that UMR adds to the equation.

In summary, collateral is here to stay, and, whatever your role in an organisation you will be impacted by it, affected by and likely working to understand it better and educate on it.

"Collateral is here to stay, and, whatever your role you will be impacted by it, affected by and likely working to understand it better and educate on it"

Shaun Murray
Managing partner
Margin Reform

Spoilt for choice

With enticing new technologies such as AI and electronic trading coming to the fore, industry experts discuss how technologies are changing the dynamic of the industry and what risks and opportunities they present

Maddie Saghir reports

'Technology' is often touted as the ambiguous answer to the many challenges and ambitions of the securities lending industry, but consensus on which new innovation should be prioritised for which problem is hard to come by.

Artificial intelligence (AI), blockchain, transaction automation, machine learning and real-time stock streaming capabilities are just some of the new tools on offer that come with promises to increase efficiency like never before and lower costs in the long-term. But, is a hefty investment in emerging technology really the antidote to all the industry's woes or just a glitzy and expensive distraction?

Today, many see fintech and regtech in one form or another to be the ultimate solution to the challenges posed by the incoming Securities Financing Transactions Regulation (SFTR) and other regulatory frameworks soon to shake-up the industry.

At the same time, discussions around the rise of electronic trading, the leap to blockchain technology and the integration of AI into decision making are taking centre stage at industry events and boardroom discussions all over the world.

However, while some are hailing the rise of the machines, others are warning to keep the new risks and challenges associated with technology in sharp focus moving forward.

What's on offer?

Industry experts suggest that electronic trading and the increasing usage of data is enabling better pricing decisions and empowering the industry in the deployment of proprietary trading algorithms.

It has also been predicted that there will be a migration towards higher proportions of trading occurring over electronic venues to allow for a better allocation of resources and to increase standardisation.

As well as benefiting from electronic trading and AI, the industry can also benefit from automation. Paul Lynch, global head of product at EquiLend, a securities lending platform, says that automation can reduce the risk of error-prone manual processes and can allow firms to focus intellectual capital on client engagement, performance drivers and risk mitigation.

Similarly, Martin Seagroatt, global marketing director for securities finance and collateral management at Broadridge, says automation can also facilitate growth in trading volumes with a reduction in operational risk.

Seagroatt sees new tech bringing lower costs across the trade lifecycle as the main benefit of automation, along with freeing up time for staff to focus on decision-making and reallocation of personnel to more productive tasks.

"Larger buy-side institutions are showing more interest in bringing some of their lending activities in house," he explains. "Automation could reduce the middle- and back-office costs of running in-house desks and make insourcing less expensive. Finally, greater automation can facilitate innovation and the ability to launch new products and business lines more rapidly."

Need versus want

Considering the digital smorgasbord of tools on offer, it's unsuprising that the various demographics of the market are looking to focus on different applications for their IT investments.

Discussing the technologies that are expected to take centre stage for banks in the securities finance industry over the next 12 to 18 months, Guido Stroemer, founding partner at HQLA^{X}, says that their solutions should centre around improving balance sheet management.

"Bank treasurers need real-time balance sheet reporting to feed optimisation engines which in turn feed into execution platforms. I believe blockchain and AI technologies can help the modern-day bank treasurer get the right financial resource to the right place at the right time," he explains.

Elsewhere, Lynch says that his clients have expressed a keen interest in screen-based collateral trading and management, screen-based swaps optimisation, additional post-trade automation tools, including AI, and expanded their usage of central counterparty trading facilities for securities lending.

However, although industry participants aspire to be the first to apply HAL 9000 to securities lending, the practical demands of the day are forcing many to settle for more modest additions to their systems.

Seagroatt says that the uptake of these new technologies such as AI, blockchain, cloud and digital or data in securities finance has been gradual. He suggests this is mainly because many IT budgets are currently focused on adapting to regulatory change resulting from SFTR, Central Securities Depositories Regulation (CSDR), Brexit and the uncleared margin reform rules.

Seagroatt predicts that the adoption of cloud technologies will continue to grow due to greater understanding of the security and data protection, as well as the benefits around flexibility and scalability that the cloud can offer. He also expects to see more firms apply robotic process automation to the securities finance lifecycle due to its relative simplicity to deploy versus more advanced AI techniques.

The need to address the reality of the market's current challenges before getting lost in space-age technology was also raised at the Securities Finance Technology Symposium in May by David Lewis, senior director at FIS. Lewis said at the time that, as a result of SFTR, lots of people will have to look at the nuts and bolts of their trading systems and behaviours and potentially need to change the way they're booking things to make sure they're getting it right.

"It can be tedious to some, and we'd perhaps rather talk about AI, machine learning and of the other shiny bells and whistles, but you need to get the base technology and data right first," he said. "We are not going to get the most from automation and the efficiency it can bring until we get the basics right. There is lots of interesting data out there, which gets our attention, brings innovation and drives competition. We talk about AI and machine learning but until we strengthen the foundations of our basic data, we won't see transformational change."

Making lemonade

For the optimists of the industry, the incoming regulations also present an opportunity to improve. "While SFTR and CSDR are currently taking up a great deal of resources, they are also enablers of technological change in the future. SFTR in particular is driving the standardisation of processes. This lays the foundation for greater automation and could facilitate the use of smart contracts over a distributed ledger," Seagroatt says.

Moreover, Seagroatt believes firms could start to leverage these datasets, along with other alternative data, to guide decision making.

"SFTR and the common domain model being discussed by the International Securities Lending Association will enable greater standardisation. This will lead to higher volumes of electronic trading - which in turn provides a foundation for greater automation, algorithmic trading and the use of AI."

On the topic of AI, Seagroatt predicts that there are areas of front-office decision-making where AI could process large volumes of data in a very short space of time.

He describes how data crunching could feed into PC-based cognitive assistants and decision support tools. "These solutions would then enable robot-assisted traders to take advantage of short-lived trading opportunities before the wider market can react. A future AI-driven system could also suggest sophisticated integrated transaction combinations to meet trading goals that are more complex than a basic single trade approach," he says.

Meanwhile, Lynch believes that the usage of data, and the sophistication of how that data is used, will only increase with time. He says: "The industry has become 'super users' of data. Many of our clients are buying data at a record level and consuming it daily."

"It is being used for trading, client and firm performance benchmarking and daily quantitative analysis. In addition, different types of firms and different departments within existing client firms are consuming securities finance data—for example, beneficial owners and portfolio managers."

The honey is sweet but the bee has a sting

Although there is much industry fanfare around the possibilities offered by emerging technologies, new roads bring new dangers.

Seagroatt warns that many industry experts and quants are also deeply sceptical about the ability of AI to ever predict financial market movements. "AI can help to increase the speed and accuracy of predicting the probability of events occurring by processing larger volumes of data faster than a human ever could," he says. "However, it would be a mistake to rely too heavily on AI for things like predicting risk. AI is also not good at predicting black swan events, tail risk, and the impact of events with no historic precedent such as Brexit."

Seagroatt also highlights that AI and quantum computing could allow hackers to crack encryption keys, although these technologies can also be used to create more complex forms of encryption. Firms therefore need a robust cybersecurity framework to monitor and mitigate threats as they evolve, he says.

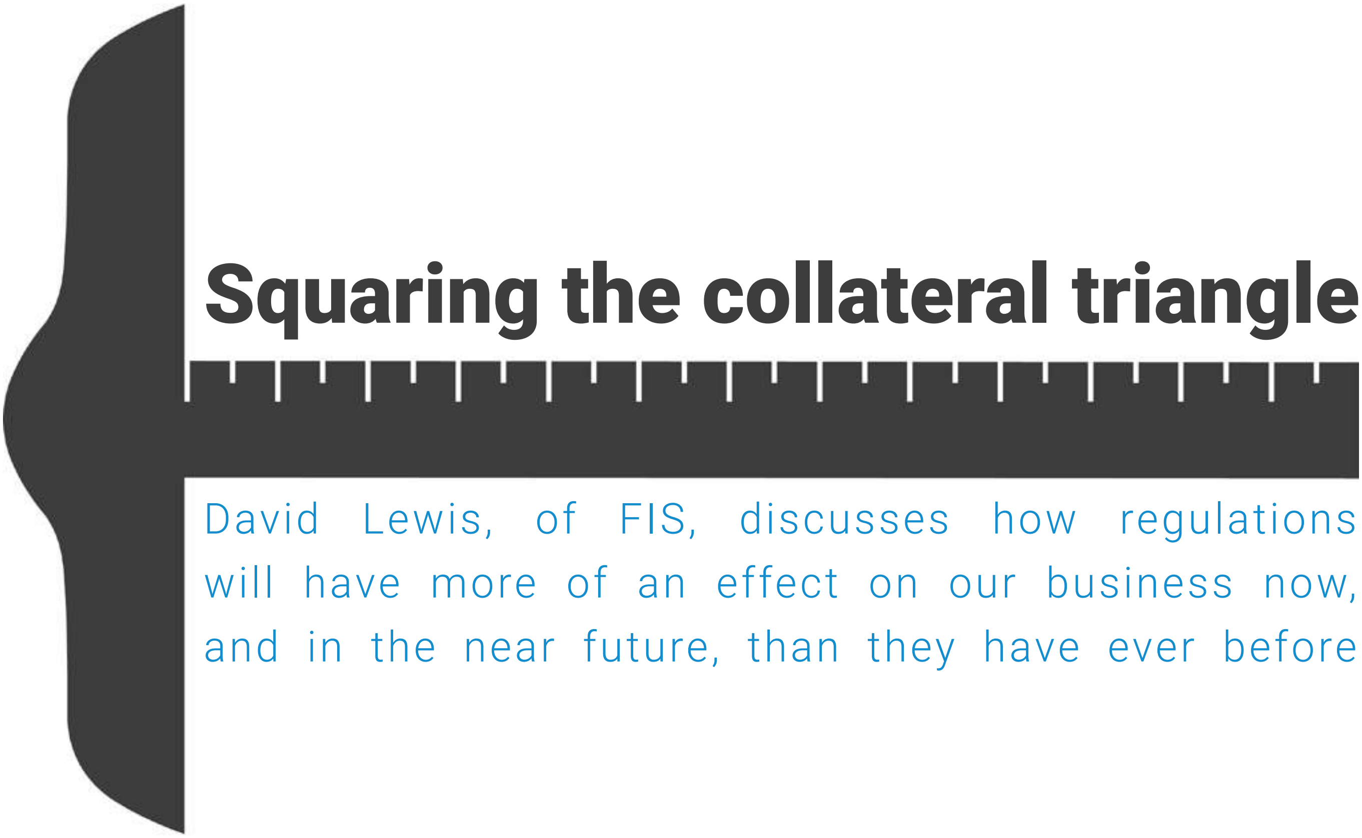
Beyond the risk of quantum hackers, more familiar concerns and limitations also remain. HQLA^{X}'s Stroemer notes that it's important for technology solutions to be able to interoperate with one another, otherwise it will create silos which may cause inefficiencies and impede market adoption. Elsewhere, model risk is a major issue, where a machine learning solution can be difficult to govern due to a lack of transparency, according to Seagroatt. "Greater complexity means fewer people understand what the AI is actually doing," he says. "There are difficulties bridging the gap between the work data scientists are doing and staff who have deep domain knowledge of industry dynamics or the trade lifecycle."

Risk management

Where there's risk, regulators are sure to be close by and Seagroatt believes that they are increasingly concerned about the shifting of risk from the banking sector to the fintech sector, which is less regulated.

"It is critical that market participants perform sufficient due diligence to ensure fintech providers have mature security procedures in place. There is also an increasing reliance on a few big cloud computing or AI providers, who could be classed as systemically important/too big to fail. There are other concentration risks where firms could all use similar AI algorithms or datasets to guide trading, resulting in herd effects," Seagroatt says.

He concludes: "These are some of the known knowns. However, there are likely to be many unknown unknowns and technology-driven risks we haven't even thought about yet. Greater interconnectivity in the market could increase the severity and magnitude of problems with contagion effects occurring very rapidly and unexpectedly. A common global regulatory framework around areas such as AI would greatly help with identifying and mitigating some of these risks."



Squaring the collateral triangle

David Lewis, of FIS, discusses how regulations will have more of an effect on our business now, and in the near future, than they have ever before

Regulations have always shaped our industry, that is their nature. However, it is probably fair to say that they are having more of an effect on our business now, and in the near future, than they have ever done before. Many column inches have been written about Securities Financing Transactions Regulation (SFTR), and now we are on the road to implementation in April 2020, the new requirement for the securities finance industry to report to a regulator is finally on the horizon. SFTR is, of course, all about transparency and bringing the world of shadow banking out into the sun, delivering on the Transparency Directive handed down by the Financial Stability Board (FSB). Combine the effect of SFTR with other forces at play in our market, including the other new regulations coming into force or already in place, then we see an influence on the market that is much wider than perhaps the original individual requirements intended.

Looking at a number of these regulations, a common thread becomes evident. Just like many other segments of the financial markets, regulators are looking to regulate out risk as far as is possible—in the same way, health and safety commissions look to protect the public from harm. Risks cannot be eradicated, of course, because without it, returns make little sense; but they can be minimised, and this is what a number of regulations are aiming at. Central Securities Depositories Regulation (CSDR), Fundamental Review of the Trading Book (FRTB), the various incarnations of Basel and, of course, SFTR, all have common factors either directly or indirectly affecting the way collateral is managed or reported.

The need for additional capital under Basel III has driven many banks to reorganise their balance sheets as they move to meet the new requirements applied to them. This has had an effect on the securities finance market as borrowers look for high-quality liquid assets (HQLA) to improve their balance sheets. However, in a report by the European Banking Authority (EBA) on the progress of Basel III implementation released this month, it is indicated that across the 189 banks questioned, the capital requirements would rise by an average of 24.4 percent. This translates, in the report's terminology of "conservative assumptions", to a capital shortfall of some €135 billion, including €91 billion of common equity tier one. Looking at large global banks, it is clear that they are carrying the larger part of this increased obligation, as medium-sized banks are looking at an average rise of just 11 percent of the capital or around €1 billion. Small banks fare even more favourably at just 5.5 percent and around €100 million of additional capital required.

In its recommendations, the EBA advises that Basel III reforms are introduced by the European Commission with regard to the "calculation of exposure values of counterparty credit risk exposures stemming from securities financing transactions (SFTs)". This would suggest that the need for HQLA is unlikely to be diminishing any time soon.

In an article, published by the Financial Times on 22 May 2019, Manmohan Singh, a senior economist at the International Monetary Fund, explained how collateral velocity is once again on the increase. Collateral velocity, first measured effectively in 2011, is the ratio of the total pledged collateral received by large banks that is eligible to be reused, divided by the primary collateral sourced from financing activities, including repo, securities lending, prime brokerage and derivative margins. In simpler terms, the ratio indicates the level of reuse of collateral due to financial intermediation between banks and non-banks, something regulators are keen to understand, and which can be seen reflected in some of the data requirements we see in SFTR.

Having dipped significantly from around three in 2017, velocity was calculated at around 2.5 between 2010 and 2011, immediately post the Lehman default and the ensuing financial crisis. Collateral velocity continued to fall, dipping to a low of 1.8 in 2016 as regulations and a general aversion to counterparty risk saw collateral pledged fall from $10 trillion to around $6 trillion. It could also be argued that quantitative easing by several central banks was also sucking up a lot of HQLA supply. Since 2016, however, it has been on the rise: two in 2017 and 2.2 in 2018. This has been caused by a growth on both sides of the equation but with primary collateral rising by only around 10 percent, while the volume of pledged collateral has grown more than three times as fast at 33 percent. While this rise has only closed half the gap that was created by the financial crisis, it does put pledged collateral back over the $8 trillion level.

But what does all this mean to the securities finance industry? The rise in primary collateral has been driven primarily by securities lending and prime brokerage activity, reflecting the additional activity in collateral sourcing and supply to meet regulatory changes. It is also indicative of market participants changing the way they trade in order to stay within new balance sheet constraints. What may follow is a loosening of those pressures as central banks begin to reduce the size of their balance sheets and free up the HQLAs that they have taken from the market. Certain central banks have undertaken securities lending programmes themselves, which have muddied the waters somewhat, but that will be offset by the reduction in the quantitative easing programmes.

The impact of FRTB has also been felt across the market as capital is allocated towards illiquid assets, and market participants have pushed away from holding anything they cannot efficiently price. This regulation is another potential demand on the capital of banks, bringing further pressure to the market. It is a regulation that is, arguably, easily defended on the basis that it is not unreasonable to expect a bank to hold capital to secure an asset that does not meet a fairly low bar on asset pricing. Anyone who has seen 'The Big Short' will understand the knock-on effect of mispricing illiquid or distressed assets. Such requirements certainly uphold the health and safety objectives of the regulators when they are considering the security of the financial markets.

With multiple regulations bringing numerous layers of complexity to the capital and collateral requirements of the financial markets, the securities finance industry finds itself firmly in the crosshairs, not least because as of April 2020 we will need to be able to report comprehensively on collateral traded and its level of reuse. The roll-out of margin requirements for uncleared derivatives will be another major driver of change, requiring either the posting of additional collateral by hundreds of more counterparties or the move into the clearinghouses.

In either case, the objective of protecting the end consumer and the stability of markets is being addressed. All we need to do now is find all that extra collateral and optimise it across all our businesses.

David Lewis
Senior director
FIS

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02

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09

Comings and goings at IHS Markit, BCS Global and more

BCS Global Markets has appointed Andrew Richards as prime services sales director, based in London.

Richards will report to Tim Bevan, global head of prime BCS Global Markets and CEO of BCS UK.

In his new role, Richards will support the firm's expansion by strengthening and expanding the global investor base in the US and Europe, along with emerging and frontier markets.

Additionally, he will be responsible for selling the firm's flagship international prime services offering to the small and mid-tier hedge fund community across various strategies.

Prior to joining BCS Global Markets, Richards held various senior roles within the prime brokerage industry.

He has over 15 years of industry experience and was most recently director of Origination Global Security Finance, synthetic prime brokerage at ING BANK in London.

Richards was also previously vice president and prime brokerage relationship manager for Bank of America Merrill Lynch in London.

Bevan commented: "We are delighted to welcome Andrew Richards in our team in London. We believe he will make a significant contribution to BCS Global Markets."

"His breadth of experience in selling international prime services and developing client relationships to the hedge fund community will be instrumental in our global expansion."

Daniel Casley takes on new role

Cantor Fitzgerald has appointed Daniel Casley as head of Europe, the Middle East and Africa prime operations, based in London.

Prior to Cantor Fitzgerald, Casley was a consultant, regulatory oversight and remediation at Societe Generale Corporate and Investment Banking.

Before serving at Societe Generale, Casley served at Deutsche Bank for 12 years in a number of senior roles, including director, global head securities lending and financial risk manager operations.

Prior to Deutsche Bank, Casley served at Lehman Brothers, Morgan Stanley and Credit Agricole—formerly Banque Indosuez.

S3 Partners has hired John Clancy as director of business development, based in New York.

Clancy moves from LUX Fund Technology & Solutions where he was pre-sales director.

He also held roles at ENSO Financial Analytics, Greenbox NY and BNP Paribas.

EquiLend has hired Grant Davies as head of sales for Europe, the Middle East and Africa, based in London.

Davies has previously worked at MatchBox as head of business development.

In his career, he has also held roles at CORE Collateral, iShares, J.P. Morgan, HSBC, BNY Mellon and Goldman Sachs.

Timothy Keenan, who has worked in the industry since 1983, has departed BondLend, a division of EquiLend, where he served as global product owner.

Based in New York, Keenan served in this role for almost six years. Prior to this, he served as head of sales and business development at AQS, a wholly-owned subsidiary of Quadriserv.

Before AQS, he worked as managing director at Barclays Capital between 1997 and 2008.

Keenan also worked at Credit Suisse First Boston, Deutsche Bank and The Chase Manhattan Bank.

Simon Martin is to join IHS Markit as a sales director for enterprise data management and thinkFolio.

Martin will cover Australia and New Zealand sales and will report to Guillaume Rondy.

He currently serves as head of multi-sector and business development, Australia and New Zealand for HSBC.

Prior to HSBC, Martin worked at JPMorgan Chase as securities lending sales and relationship vice president for South East Asia, Australia and New Zealand.

He has also served at Northern Trust as investment manager liaison representative and trade processing supervisor.

Bloomberg has confirmed that RegTek. Solutions CEO Brian Lynch, will continue in his role following its acquisition of the regulatory reporting solution provider.

Alejandro Perez, global head of post trade solutions at Bloomberg, said: "Brian Lynch has joined Bloomberg and is fully committed to delivering the integrated reporting solutions that the combination of RegTek and Bloomberg's post-trade reporting business."

Lynch, who founded RegTek in 2017, said: "RegTek has built an award winning product and impressive, tier-one client base".

"Combining our solutions with the strength and scale of Bloomberg's RHUB services, as well as access to their market data, enterprise data management, analytics and enrichment capabilities will allow us to offer the cross jurisdictional, cross asset solutions that our clients demand," he added.

LCH has appointed Isabelle Girolami as CEO of LCH, effective on 1 November.

Based in London, Girolami will report to Daniel Maguire, LCH Group CEO.

In her new role, Girolami will be responsible for driving continued expansion across LCH's services, with a focus on continued growth, innovation.

Girolami joins from Crédit Agricole, where she has most recently served as deputy CEO of its corporate and investment banking business.

Girolami's appointment follows Martin Pluves' decision to step down as CEO of LCH to pursue other opportunities as of 31 July.

In the interim period, Daniel Maguire will take on the role of CEO of LCH, in addition to his other responsibilities until Girolami joins.

Credit Suisse has snapped up David Fazel for its Delta One desk in London.

Fazel makes the move from Deutsche Bank where he was vice president, portfolio manager since 2016. Before that, Fazel worked at Nomura for six years from 2010.

At Nomura he initially served as an equity finance trader before becoming vice president and Delta One, equity finance trader in 2015.

Seema Arora joins Nomura Group

Instinet, a wholly-owned execution services arm of Nomura Group, has appointed Seema Arora as head of execution sales for Europe, the Middle East and Africa.

In this newly created role, Arora will head a team responsible for selling all Instinet execution products.

Based in London, Arora will report directly to Richard Parsons, CEO of Instinet Europe.

Arora joins Instinet after 10 years at Kepler Cheuvreux where she most recently held a similar role in execution sales.

Previously at Kepler, she served as global head of portfolio trading.

Before Kepler, Arora worked in various senior equities and derivative sales roles both at J.P. Morgan and Dresdner Kleinwort Benson.

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