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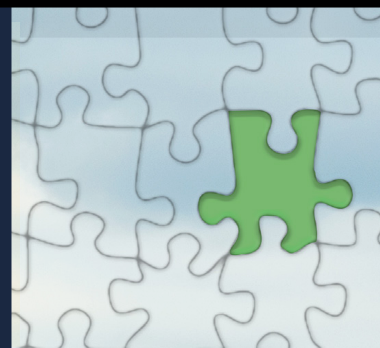

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EXCLUSIVE: Two-thirds of firms will not be fully ready for SFTR go-live, survey shows

A survey of securities financing industry participants has revealed that the majority of firms are still in the early stages of preparing for the reporting requirements of the Securities Financing Transactions Regulation (SFTR), while two-thirds do not expect to be fully ready by the April 2020 deadline.

Regulatory reporting service provider Cappitech surveyed 87 banks, asset managers, trade repositories, agent lenders, brokers and non-financial entities in August and early September to review the industry's state of readiness ahead of next year's deadline.

Of the respondents, 65 confirmed they would be in-scope for SFTR's reporting obligations.

In total, 40.2 percent of respondents are headquartered in the UK and 31.9 percent are EU based.

In terms of general readiness, nearly two-thirds of respondents said they haven't started the implementation of their SFTR solution, as of September.

Just over 63 percent of respondents are either in the planning phase or pre-planning phase.

Of this section, 11.5 percent had not started planning, while 32 percent had started planning and 19.5 percent claim to have made significant progress in planning.

Meanwhile, the survey results indicated that 28 percent of participants had started implementation, while only 9 percent claimed to be fully ready for SFTR.

Regarding testing of SFTR solutions, nearly 11 percent of respondents said they were not planning to test at all, while 7 percent responded that they would only test in the final month ahead of go-live. Moreover, approximately 54 percent stated that they only expected to be ready to test in the final three months prior to go-live.

Commenting on the results, Jonathan Lee, senior regulatory reporting specialist at Kaizen Reporting, said: "We would caution that these dates have a tendency to slip and that three months will not necessarily prove sufficient to launch such a large and complex reporting regime. Both Kaizen and Cappitech clients have seen many reporting parties suffer major setbacks in their regulatory programme deliveries and consequently only perform the very minimum of testing very late in the day."

"This has very negative implications for data quality and regulatory compliance."

Touching on the reasons why so many firms appear to be in jeopardy of missing the April deadline, Ronen Kertis, CEO of Cappitech, explained that the industry experienced a similar scenario with the implementation of the Markets in Financial Instruments Regulation and the European Market Infrastructure Regulation. Kertis noted that nine or six months before those regulations went live, a lot of firms weren't ready or even in the implementation phase and that it had an effect on the quality of data that was reported in the first month of go-live.

According to Kertis, the survey results indicate that some in the industry have not learned the lessons from navigating the builds for previous regulations and have continued to prepare in the eleventh-hour.

Lee added: "For UK-based firms, Brexit is going to be high on the agenda for the immediate future. But also, there is still an element of uncertainty generally. Where we had the level-three European Securities and Markets Authority technical guidance notes published earlier in the summer, they in many ways asked more questions than they answered."

As a result, Lee explained, some firms are holding back from committing to a build until they get further clarity from the final guidance notes due in Q4.

"There has to be a leap of faith in certain areas such as the need to provide full reports for errors and modifications, rather than delta reports. The timeline is such that if you're involved in the first phase of go-live then you can't hold back any longer," he said.

"Given that this is a completely new regulatory environment, as we don't historically have a transaction reporting regime for the securities finance business, it's key to get yourself in a position where you run something in parallel for some period to really bed the system in, with the knowledge and understanding, and to remediate any immediate issues."

Moreover, Lee explained that both EU- and UK-based firms are still hampered in their build schedules by the fact that several TRs have only just begun user acceptance testing and haven't set their pricing yet. As a result, more than 40 percent of respondents still haven't decided which TR they are intending to use.

According to Lee, this combination of factors has caused a situation where only 37 percent of respondents expect to be fully ready for SFTR on time.

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OCC sees August slide in securities lending activity

Equity derivatives clearing organisation Options Clearing Corporation (OCC) saw its securities lending central counterparty activity fall by 5.53 percent in new loans last month, compared to August 2018.

OCC reported that its year-to-date securities lending activity was down 2.56 percent, representing 899,943 new loan transactions, from the same period in 2018.

The average daily loan value at OCC in August was $76.8 billion a decrease of 4.4 percent compared to August 2018.

RBI reveals plans for a securities lending programme

The Reserve Bank of India (RBI) is working with market regulators on a securities lending product to improve the country's capital market liquidity and avoid another short-squeeze incident, according to the bank's deputy governor Shri Kanungo.

Speaking at a joint conference by the Fixed Income Money Market and Derivatives Association of India and the Primary Dealers Association of India in Moscow earlier this month, Kanungo said the bank is looking at ways to improve market stability in several ways, including by building up India's fixed income markets.

"The importance of the fixed income markets cannot be overemphasised," he told audience members. "Apart from the fact that these markets meet the fund's requirement of the sovereign and sub-sovereign bodies across the globe, they also substantially meet the external fund requirements of financial as well as non-financial firms."

Kanungo added that one of the most important prerequisites of a liquid and robust market is wide participation by agents with large volumes of merchandise.

In this respect, he noted that banks constitute the single largest set of entities, followed by insurance companies and pension funds, along with alternative investment funds.

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Currently, he explained, these institutions are sitting on large balance sheets of high-quality assets, such as government bonds, that are not able to be active in the market. As a result, RBI is seeking to enhance the overall liquidity in the government securities market in terms of availability of two-way quotes in less liquid maturities through targeted market-making schemes.

It is also taking steps towards the "activation of a securities lending and borrowing programme and interoperability of depositories for a smooth transfer of ownership in securities".

Kanungo also used his speech to call on India's market regulators to assist in developing the country's interest rate markets.

"For instance, short selling activity could benefit if a wider pool of securities lenders can be developed," he added. "Insurance and pension funds and mutual funds have significant holdings of government securities that could be lent to short sellers."

"This would avoid the short-squeeze incident we saw a couple of years back, apart from generating income for these entities. We are working with regulators to develop a securities lending product that could enable these entities to participate in securities lending."

For India, government securities constitute the largest segment of its fixed income market, standing at roughly INR 58 trillion ($806.7 trillion), with treasury bills accounting for another INR 6 trillion (US$83.4 trillion), according to Kanungo.

Meanwhile, the country's corporate debt market has grown from INR 14.43 trillion (US$200.7 billion) to INR 30.63 trillion (US$ 344.7 billion) from June 2014 and June 2019.

tZERO: Byrne departure won't stop product launch

The CEO of blockchain trading venue tZERO has assured investors that the sudden, high-profile loss of Patrick Byrne as CEO of tZERO's parent company, Overstock.com, will not derail upcoming updates to its securities lending services.

Saum Noursalehi, who became CEO of tZERO in May 2018 after 14 years rising through the ranks of Overstock.com, published a letter to investors addressing recent events and clarifying the firm's roadmap for the coming months.

"While we are sad to see him go, I can assure you that Patrick's departure will have no impact on tZERO's day-to-day operations or the execution of our roadmap," the letter reads.

Byrne resigned in August, citing his on-going involvement in an investigation into potential

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Russian espionage in the US by the Federal Bureau of Investigation as making his role leading the online retailer untenable.

Elsewhere, Byrne has also been an outspoken critic of the securities lending and short selling markets, which he has accused of being too opaque to be managed effectively.

In 2017, while speaking at the Money20/20 financial technology conference in Las Vegas, Byrne further argued that the settlement crisis of September 2008 was caused by "mischief on the securities lending desk".

He has also clashed with those seeking to short sell shares of Overstock.com who he believes wish to see his blockchain alternative trading venue fail.

Byrne was succeeded by Jonathan Johnson, who stepped in as interim CEO, while also continuing as chairman of tZERO's board.

Elsewhere in the letter, Noursalehi highlighted plans to enhance and build out tZERO's securities lending solution as one of the firm's key priorities for the rest of the year.

tZERO plans to launch the next iteration of its digital locate receipt (DLR) product next month, which aims to provide clear and accurate insights into pricing and inventory orders to reduce transaction costs.

In August, tZERO completed the market data feed portion of DLR 2.0, which aggregates the supply of hard-to-borrow inventory from multiple sources.

According to Noursalehi, the next phase, due in October, is to integrate this technology into tZERO's order management system, which should allow short sellers to introduce bids and receive locates on hard-to-borrow stocks.

In a statement on the update, tZERO said that these two developments will increase efficiency and reduce failures to deliver for global securities.

OCC settles with US regulators on risk management failures

Options Clearing Corporation (OCC) has agreed to a $20 million fine and a major reshuffle of senior staff and risk management functions to respond to charges of failing to manage certain market risks.

The US Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) has this week found the Chicago-based equity derivatives clearing organisation to have "failed to establish and enforce policies and procedures involving financial risk management, operational requirements, and information-systems security".

The SEC's investigation also found that OCC changed policies on core risk

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management issues without obtaining the required approvals.

As the US's only registered clearing agency for exchange-listed options contracts on equities, OCC was designated as a systemically important financial market utility in 2012, thereby making it subject to enhanced regulation and transparency rules related to risk management.

CFTC chairman Heath Tarbert commented: "As this case shows, principles-based regulation does not mean lax oversight."

"While clearing agencies have some discretion in crafting their risk management policies and procedures, those policies and procedures must be reasonable and take into consideration relevant risks."

Without admitting or denying the SEC's and CFTC's findings, OCC agreed to pay $15 million under the SEC's order and $5 million under the CFTC's order and hire an independent compliance auditor to assess its remediation of the violations and subsequent compliance efforts.

The SEC confirmed that this week's enforcement action is the first charging violations of its clearing agency standards adopted in 2012 and in 2016, and the CFTC's first charging violations of core principles applicable to a derivatives clearing organisation.

In a statement on the settlement, OCC confirmed it has already developed remediation plans to enhance its margin policy, incorporate stress testing and liquidation costs into its clearing fund and margin methodologies, respectively. The plans have been approved by the SEC.

The CFTC noted that the plans will bring OCC into compliance with the core principles and regulations required of clearinghouses.

As part of comprehensive efforts to correct the short-falls, OCC executive chairman Craig Donohue has also reshuffled many of OCC's senior executives, including handing over the reins of CEO to John Davidson, while retaining his other role as chair.

Davidson, who joined OCC in 2017 as president and chief operating officer (COO), was approved for the top job by the SEC in February.

Meanwhile, Scot Warren, OCC's former chief administrative officer, took over as COO in the same month.

The OCC board made further changes to several other senior roles, including head of financial risk management, chief information officer, chief security officer, and heads of control functions.

Moreover, OCC has increased the number of staff responsible for risk management, compliance, legal, and information technology.

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Commenting on the settlement, Davidson said: "We take our responsibility to promote the stability and integrity of markets seriously, and we are committed to operating as a resilient clearinghouse and maintaining the highest standards of regulatory compliance throughout our organisation."

"Our commitment is reflected in the progress we have made as most of the compliance remediation is now complete and any remaining actions are on a path to be completed expeditiously."

DTCC opens testing on Delta Capita's SFTR test pack

The Depository Trust & Clearing Corporation (DTCC) has begun user-acceptance testing (UAT) on Delta Capita's standardised industry test pack for Securities Financing Transactions Regulation (SFTR) transaction reporting.

David Field, head of the securities finance practice at Delta Capita, explained that the SFTR test pack aims to provide full traceability to the regulatory technical standards/implementing technical standards, along with the European Securities and Markets Authority's guidance and industry best practices for SFTs.

"It [the pack] will provide users with the test data, test scripts and the expected results they need to conduct their UAT. Users will also be able to test with their counterparts, trading venues, service providers, central counterparties, triparty agents and trade repositories," Field said.

The test pack is the product of an industry working group that was formed by Delta Capita in May, and includes eight global banks that operate as agent lenders and brokers, with the aim of mutualising the costs of preparing for SFTR.

Delta Capita also gained the support of industry trade associations, such as the International Securities Lending Association and the International Capital Market Association, along with service providers and trade repositories (TRs).

The test pack has since been shared with DTCC, which begun trialling it with its own SFTR matching and reporting service on 30 August, ahead of the regulation's implementation on 11 April 2020.

According to Delta Capita, clients of DTCC's global trade repository service for SFTR, who independently license the consortium's test pack, will benefit from knowing the service has already been tested, and will thereby reduce their own testing effort and costs and ensure readiness for trade reporting.

As part of the partnership between DTCC and Delta Capita, DTCC will also make its data transformation services available to Delta Capita's banking consortium to assist with the creation of TR-ready ISO 20022 SFTR reports.

Eurex launches OTC derivatives Switch Incentive Program

Eurex Clearing is seeking to capture over-the-counter (OTC) interest rate derivatives activities shifting to the EU27 from the UK after Brexit with a new central counterparty (CCP) Switch Incentive Program.

The programme will operate until year-end 2019 to support market participants in migrating OTC interest rate derivatives positions and provides for a 100 percent discount on booking fees for portfolio switches to Eurex Clearing until the end of 2019.

The programme comes in response to recent calls from regulators and central banks warning market participants to prepare for all possible Brexit scenarios and reiterated that the EU's temporary measures for CCPs expires in March 2020.

Currently, a large part of the multi-billion euro derivatives business has been conducted in London, but following the UK's withdrawal from the EU on 31 October, EU supervisors may no longer have the necessary powers for effective market oversight.

Market participants speculate that the London Stock Exchange (LSE) may continue to settle euro derivatives for a transitional period even in the event of a No-Deal Brexit to avoid market distortions.

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Asset Encumbrance in European Banks

The level of asset encumbrance in EU banks remains stable, standing at 27.9 percent, based on a data sample of 181 EU banks. This follows a steady upward trend over the last decade. The European Banking Authority (EBA) announced in its fifth annual asset encumbrance report that the level of encumbered assets and collateral has increased in line with total assets and collateral received. Under Regulation (EU) No 680/2014, EU banks have prescribed templates for reporting asset encumbrance.

Asset encumbrance arises from a claim on an entity's assets that are used to secure borrowing. The lender will have a claim in law against the borrower in the event of the later defaulting on its obligations. The Bank of International Settlements (BIS) defines encumbered assets as "assets that the bank is restricted or prevented from liquidating, selling, transferring or assigning, due to regulatory, contractual or other limitations. Goldman Sachs defines it as: "pledging or use of an asset as a means to secure, collateralise or credit-enhance any on-balance-sheet or off-balance-sheet transaction from which it cannot be freely withdrawn."

While the increase in the requirement for high-quality collateral for lending is welcome (credit risk is mitigated), it has the knock-on effect of reducing the pool of assets available to liquidators in the event of default or bankruptcy. It also reduces liquidity (increased liquidity risk) as the asset is unavailable for use.

While no target encumbrance ratio exists, the fact it is stabilising suggests the market is gravitating towards a new normal following the 2008 global financial crisis.

Despite the stable asset encumbrance, there is variation across countries. Countries with large banking sectors (the UK, France and Italy) have recorded an increase in their bank's asset encumbrance ratios. These were offset by a decrease in the ratios of other countries with large banking sectors (e.g. Germany, Spain, Belgium and Sweden).

Greece was a standout reporting a large decrease in its ratio. This indicates Greek banks are less dependent on central bank funding and are recovering from the recent sovereign debt crisis.

As for the sources of encumbrance, repos remain the principle source: 30 percent in 2018. In the UK and France, repos account for 44 percent and 34 percent, respectively, of encumbered assets. Other principle sources are the shares of covered bonds (17 percent) and central bank funding (10 percent). With the Securitisation Regulation now in force, both commercial paper and longer-term securitisations are set to pick up.

The maturity of the encumbrance (how long an asset is unavailable) is equally important. In this regard, no major changes in trend were noted in 2018. In the graph shown, open and less than one week continue to be the largest two maturities.

Objections were previously raised concerning what constitutes collateral received. The EBA has clarified that all of the following are included: repos; securities lending, including other forms of secured lending; collateral agreements for example in derivatives contracts; collateralised guarantees; collateral placed in clearing or CCPs; central bank facilities; securitisation structures and assets in cover pools for bond issuance. The clarification is welcome and has been directly referred to in reporting.

Regulatory developments

As the shares of covered bonds constitute 17 percent of asset encumbrance, the new covered bonds framework that amends Capital Requirements Regulation should be noted. Article 129 of the directive allows covered bond investors to have "direct recourse as preferred creditors." The directive also requires the cover assets to be segregated from the overall insolvency estate.

As discussed, the data suggests a stabilisation of encumbrance ratio which must be welcomed. There exists a fine balance between decreasing credit risk, and reducing liquidity to such an extent that the financial system seizes up.

The EU should be commended for being early adopters of mandatory encumbrance data reporting, whereas other jurisdictions lag behind. The latest Basel Committee template (DIS31) should be analysed for future developments.

Seb Malik
Head of financial law
Market FinReg

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Judge dismisses antitrust conspiracy case appeal

The former owner of stock loan platform AQS has had its latest legal maneuver to revive an antitrust lawsuit against several securities lending brokers rejected

Drew Nicol reports

The former owner of AQS, a stock loan platform, has seen its attempt to reopen a previously dismissed antitrust lawsuit, by seeking to amend its original claims rejected.

QS Holdco, which owned and ran AQS before selling it to EquiLend in 2016, was seeking to revive its case against some of the largest members of the securities lending market in order to present new facts that it said would alter the opinion of the court that dismissed its case in August.

In January, QS Holdco originally filed an antitrust lawsuit in the US District Court for the Southern District of New York, asserting that several brokers, including Bank of America, Goldman Sachs and Merrill Lynch, along with EquiLend, boycotted the AQS platform.

In the filing, QS Holdco claimed to be "the victim of a conspiracy by defendants to boycott a stock lending platform that it developed and owned".

It argued that the defendants were threatened by the electronic trading platform as it offered transparent pricing, central clearing and the ability for parties to trade directly without prime brokers acting as "gatekeeping middlemen".

QS Holdco further alleged that the defendants conspired to eliminate the platform.

However, the complaint was dismissed by US circuit judge Richard Sullivan on 7 August on the grounds that the claims no longer belong to the company that brought them.

Judge Sullivan agreed with the defendant's argument that all claims were assigned from Quadriserv, the parent company of QS Holdco, to EquiLend in 2016 when the latter purchased AQS for $5 million.

On 3 September, law firm Wollmuth Maher & Deutsch, on behalf of QS Holdco, filed a memorandum of law in support of its motion to allow it to submit new evidence, which claims that EquiLend knew of the alleged "boycott conspiracy" in 2009 and therefore knowingly took away its antitrust claims as part of the purchase.

QS Holdco claims to now hold "specific facts" to show that it was not aware of the alleged conspiracy until 16 August 2017, when the complaint was filed in the securities lending class action before judge Failla, Iowa Public Employees' Retirement System v. Bank of America.

But, on 10 September, the memorandum was dismissed by judge Sullivan, who shot down the request on the grounds that the argument put forward in the motion had already been made and dismissed during the initial hearing.

The judge ruled that the claim, that the importance of the alleged conspiracy was not emphasised correctly in the original hearing, did not warrent granting QS Holdco's request to alter its previous filing or review his dismissal of the ruling.

By way of a safety net, the memorandum had additionally argued that if this first request failed, then as an alternative, the plaintiff's claims should be dismissed 'without prejudice' so that they can be determined under New York law, as opposed to federal law.

The request was based on the fact that QS Holdco's initial claim in its federal antitrust suit that the defendants were in violation of the New York antitrust statute, known as the Donnelly Act, had not been addressed or invalidated by the dismissal.

New York's antitrust laws are largely collected into the Sherman Act and the Donnelly Act. The memorandum argues that the court dismissed the plaintiffs' Sherman Act claim with prejudice on summary judgment because the plaintiff failed to meet its standards for proving a federal antitrust conspiracy.

However, with respect to the plaintiff's Donnelly Act claim, the court did not dismiss it with prejudice and therefore left open the possibility that the claim could go forward.

Moreover, the memorandum argued that the Donnelly Act is interpreted in a stricter way in several key areas in federal law, as opposed to New York state law. As such, the plaintiff is now seeking to have the case heard under New York state law as it could make a fundamental difference to the ruling.

To this request judge Sullivan said he would entertain a further briefing on the issue as it was not an argument that was raised at the initial hearing.

QS Holdco has until 27 September to file the briefing with the court as a last gasp effort to keep its claim alive.

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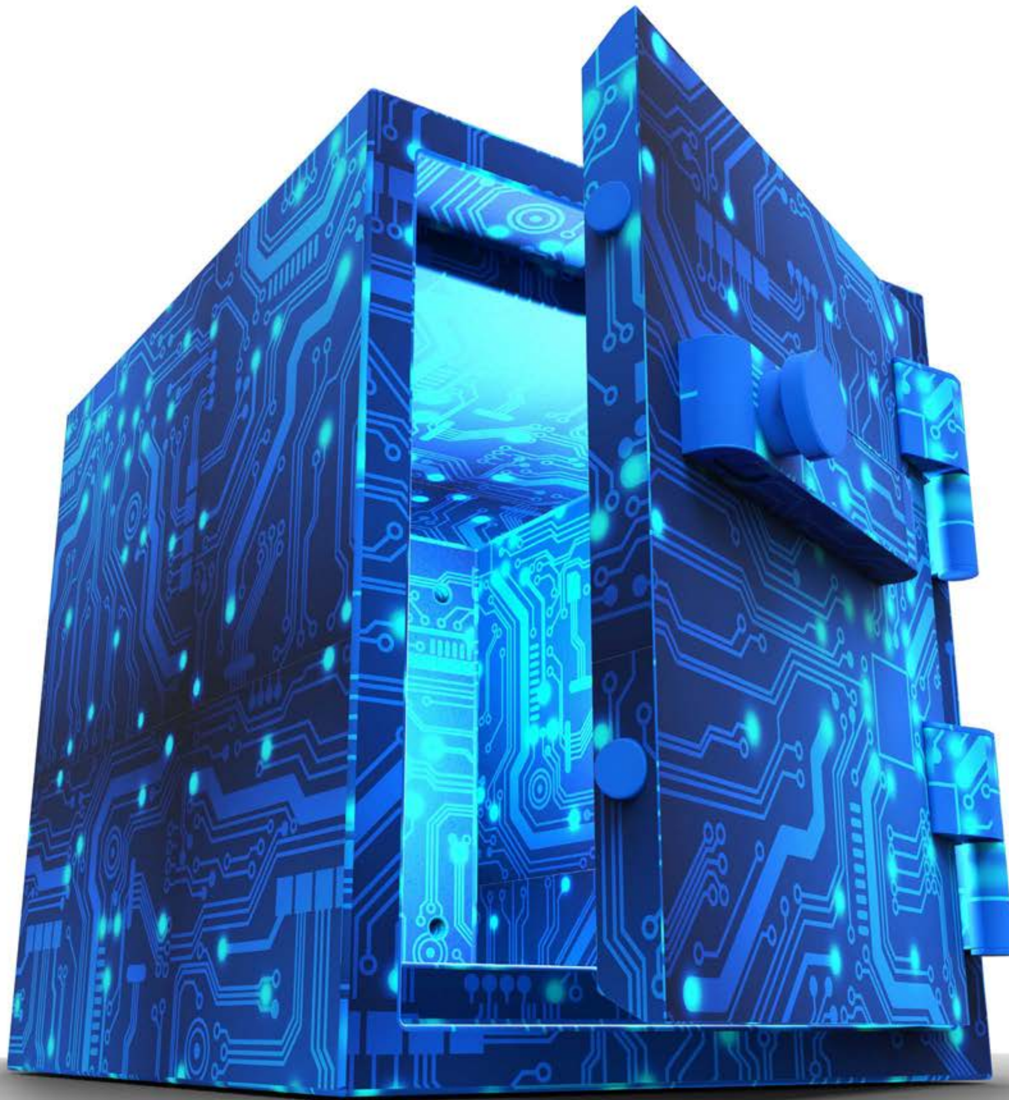

The digital appeal

Ledger Vault's Loic Jeanjean and Alexandre Lemarchand discuss the growing appetite for digital assets from institutional investors

Justin Lawson reports

Has the appetite to hold digital assets across institutional investors increased in the past few years?

Loic Jeanjean: Institutional interest in digital assets is steadily increasing. The Harvard Management Company (the largest academic endowment in the world) put something between $5 and $10 million into cryptocurrency. In May, a Fidelity survey asked institutional investors including pensions, hedge funds and endowments what they thought about digital assets. Just under half, 47 percent of respondents, reported an "overwhelmingly favourable" opinion of digital assets while 72 percent of respondents said that they prefer to buy investment products that hold digital assets. The study indicated that "institutional

investors are finding appeal in digital assets and many are looking to invest more in digital assets over the next five years".

What are the primary considerations with the buying/selling/holding and custody of digital assets?

Alexandre Lemarchand: Proper custody of digital assets is not as easy as locking up gold or paper currency in a bank vault. Since cryptocurrencies like Bitcoin and Ethereum exist completely digitally on a blockchain and are by nature maintained in a decentralised environment, they present an enticing target for hackers. Further, institutions dealing with public and private keys on such a large scale isn't easy. Secure storage of large digital asset funds is complex, and institutions need safe, comprehensive and integrated storage solutions.

Industry reports have shown that some $1.7 billion in cryptocurrency was stolen last year. The threat landscape faced by investors is similar to those facing security professionals in all tech spaces and will only become broader as the industry grows. From social engineering to traditional cyberattack methods like site clones, phishing and SMS hacks, to basic hardware tampering, there are many entry points in this new frontier.

Cryptocurrencies and other digital assets present unique challenges to custodians. What are these challenges? And, does this present the custodian community with commercial opportunities?

Lemarchand: Effective cryptocurrency custody solutions should ensure there are no single points of failure within an organisation. Think about the QuadrigaCX case in which $163 million disappeared. While that's now developing into a matter of extreme fraudulence and one bad actor, it showed on a tremendous scale that the danger lies in trusting single points of failure.

For the cryptocurrency industry to truly mature, institutional investors are going to have to get involved. Exchanges, brokers, asset managers, over-the-counter (OTC) traders, custodians and others must enforce institutional-grade controls on all transactions. It's the only way to bring about a new era of stability and trust in this new era of digital asset management.

What is meant by 'hot storage' and 'cold storage' and which is best suited to the institutional investors?

Jeanjean: The distinction between the two of these is that hot wallets are connected to the internet while cold wallets are not. Leaving your crypto on an exchange is an example of hot wallet storage. Naturally, cold wallets are considered safer than hot wallets, as they spend little (or no) time connected to the internet.

Hardware wallets of the cold variety are generally considered the best and safest option for storing cryptocurrency. These are typically in USB format and can be temporarily "hot" in that they can be connected to the internet to facilitate a crypto exchange, but primarily remain offline and disconnected with assets fully isolated and inaccessible to hackers.

While USB-based hardware wallets are undeniably the best way for individuals holding cryptocurrency to protect their investment, they're not practically viable for enterprises handling millions of dollars' worth of crypto. In the early stages of institutional investing, asset managers would find themselves securing massive amounts of wealth on hardware wallets with no convenient and efficient way to implement meaningful segregation of duty.

The financial industry really needs custody solutions that are more holistic in their approach, combining both hot and cold approaches, and encompassing both hardware and software technology solutions.

> ***Institutional interest in digital assets is steadily increasing. The Harvard Management Company put something between $5 and $10 million into cryptocurrency***

Loic Jeanjean
Head of marketing
Ledger Vault

In the US, this new class of digital assets falls under the jurisdiction of multiple regulatory agencies...only time will tell how regulation in the US will shake out

Alexandre Lemarchand
Vice president global sales
Ledger Vault

How are regulators viewing the emergence of these alternative asset classes and how is the service community interacting and responding?

Lemarchand: The world of cryptocurrency is relatively new to regulators. In the US, this new class of digital assets falls under the jurisdiction of multiple regulatory agencies. The US Securities Exchange Commission has taken the lead, but only time will tell how regulation in the US will shake out.

What does the digital custody landscape look like in three years' time?

Jeanjean: As cryptocurrency awareness grows, the digital custody landscape will as well. In three years' time, there will be more institutional investors on the scene diversifying their portfolios with digital assets. More regulated custodians will be on the scene supporting serious long term growth for individual investors, asset managers and family offices.

Overall, how safe is digital custody and how are service providers looking to protect holdings as we all move to a world of digitalisation?

Lemarchand: There is no denying that the digital asset world is one that is constantly under attack. We spend significant time and effort to assess the security of our technology along with our industry's. As hackers become more sophisticated, there is no question that our industry will be forced to adapt and create novel technology, which is exactly where our work leads us.

Researchers like us are consistently publishing findings to raise awareness about the security of our industry, and also to lay the groundwork for other security researchers. Our intention is that this work will lead to additional research and improve the overall security of the industry. Designing security is serious, hard work. Those working in this field spend a lot of time and resources trying to create secure solutions. **SLT**

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Tesla: Back in pole position

The ride seemed to be over for Tesla's short sellers by the end of 2018, but, thanks to Tesla's eccentric CEO, it seems the stock has plenty more energy in the battery

Maddie Saghir reports

When you hear the word "Tesla", what springs to mind? Beautiful, electric driverless cars, rockets and spacecraft, or perhaps if you're in the securities finance industry, volatile stocks and short selling opportunities galore.

Thanks to a laundry list of headline-grabbing affairs in 2018, ranging from controversial production targets to Tesla's eccentric CEO Elon Musk who is willing to risk his company's share price by smoking cannabis during a live podcast, to tweeting out plans to take the whole business private, Tesla has never failed to feature among the hottest shorting stocks around.

In fact, a year of turmoil led Tesla to rank as one of the top five earners for short sellers in 2018, according to DataLend. The data provider found that Tesla, along with the other top earners in 2018 (Celltrion, Ubiquiti Networks, Sharp and Sirius XM) short sellers banked $482 million in revenue.

For Tesla, the extreme volatility was particularly ramped up from May through to August 2018, which was partly down to Tesla's earnings report and Musk's provocative statements on Twitter.

Sam Pierson, director at IHS Markit, noted that Tesla saw shares end flat for the first week in May (2018), and the much-discussed Tesla earnings report and conference call certainly added to the volatility.

Following this, in early August 2018 Tesla's equity short position was above $13 billion for the first time, which compared to the previous peak of $12.8 billion in June. This came after Saudi Arabia's sovereign wealth fund took a $2 billion stake in Tesla shares.

Then, on 7 August 2018, Musk posted a message on the social media website Twitter claiming that he would take Tesla private and that the funding for doing so had been secured. He wrote: "Am considering taking Tesla private at $420. Funding secured".

Shareholders responded by saying that this was an attempt to manipulate Tesla's stock price and ruin plans for short-sellers. Following this, shareholders filed a class-action lawsuit, claiming Musk's tweet represented false and misleading information.

The US Securities and Exchange Commission (SEC) went on to charge Musk with a securities fraud charge and charged Tesla with failing to have required disclosure controls and procedures relating to Musk's tweets. This saga caused Tesla shares to drop 3.4 percent to $284.96, down about 8.5 percent for the year (as of 18 September 2018), according to Bloomberg.

Musk and Tesla agreed to settle seperate charges against them and were slapped with a $20 million fine each by the SEC. As well as this, Musk was required to step down as the company's chairman and agree to have statements on social media pre-approved.

After this however, around the end of the year, the ride finally seemed over for Tesla's short sellers. At the start of November, the number of Tesla shares borrowed declined by 6.9 million to a year-to-date low of 22.4 million, according to IHS Markit.

The total short interest fell a further 1.5 million over the last two weeks of November to 27.9 million, the lowest level since March. At the time, IHS Markit suggested that lenders were reporting 16 million shares as available to borrow, equating to $5.4 billion.

The total lendable pool, including shares already lent out, had been consistently in the range of 30 to 31 million shares since the start of November, IHS Markit explained that recent securities lending availability increase is purely the result of existing borrows being returned.

Encore!

But, as it turned out, the party wasn't over. Today, the electric car manufacturer has reclaimed pole position as the second-largest short target in the US market, behind Apple (see figure 1).

Tesla comes in at $9.14 billion compared to Apple's $10 billion while the third largest short in the US, Microsoft, comes in at $6.4 billion, significantly lower than Tesla's.

For Musk, the trouble started again in February when he defied the courts with an unvetted tweet claiming that Tesla would produce about 500,000 cars this year. This led the SEC requesting a court to hold Musk in contempt.

Following this, the law firm Grant & Eisenhofer brought suit on behalf of institutional investors against Musk and the board Tesla asserting that the CEO's ongoing unchecked misstatements on Twitter have continued to harm the company and its shareholders. According to Grant & Eisenhofer, shareholders were asking for injunctive relief and monetary damages with respect to Tesla's use of Musk's personal Twitter account to make statements concerning the company.

Speaking in March, Michael Barry, Grant & Eisenhofer director, stated: "Mr Musk has continually disregarded all efforts to rein in his material misstatements on social media. He has ignored federal court orders, a settlement with the SEC, and even his company's own corporate policies expressly requiring that any of his tweets regarding Tesla be pre-screened. His conduct has not only cost Tesla shareholders dearly but threatens to expose the company to even greater liability and litigation in the future."

Several months on and Tesla short sellers are refusing to let this particular golden goose go. At the time of writing, Data from S3 Partners shows that Tesla short interest is $9.11 billion (with a 0.73 percent stock borrow fee), representing 39.32 million shares shorted; 29.63 percent of its float.

"Tesla short sellers have reversed course after covering 4.86 million shares of their short book in 2018, a decrease of 16 percent, they have been in short selling mode for most of 2019 (see figure 2)," explains Ihor Dusaniwsky, managing director of predictive analytics, S3 Partners.

Over the past month Tesla shares shorted have increased by 13.75 million shares ($3.19 billion), 53.77 percent in 2019 as its stock price fell 30.35 percent, according to Dusaniwsky (see figure 3).

"Tesla short sellers have been selling into price weakness for most of the year and are up $2.85 billion in year-to-date mark-to-market profits (32.37 percent). Over the past month, with Tesla's stock price rallying a bit, short have given back $245 million in mark-to-market losses, 2.73 percent," he notes.

He concludes: "Tesla continues to be an active and vigorously defended short, as I can attest from my Twitter feed, and even though short sellers are down $2.49 billion in mark-to-market losses since 2016, this year's $2.85 billion in mark-to-market profits and relatively cheap financing rates (73bps fee) will not be a reason for Tesla shorts to close out their positions."

"Their recent profitability has in fact given them a profit/loss cushion that makes the chances of a Tesla short squeeze even more improbable." **SLT**

Figure 1

	Largest Domestic Shorts	Ticker	$ Short Interest
1	APPLE INC	AAPL US	$10,027,198,673
2	TESLA INC	TSLA US	$9,114,487,407
3	MICROSOFT CORP	MSFT US	$6,433,587,571
4	AMAZON.COM INC	AMZN US	$6,407,633,598
5	BRISTOL-MYERS SQUIBB	BMY US	$6,349,656,733
6	NETFLIX INC	NFLX US	$6,053,734,637
7	VISA INC	V US	$5,458,701,612
8	FACEBOOK INC	FB US	$5,134,023,969
9	CHARTER COMMUNICATIONS	CHTR US	$4,606,276,164
10	AT&T INC	T US	$4,470,870,977

Figure 2

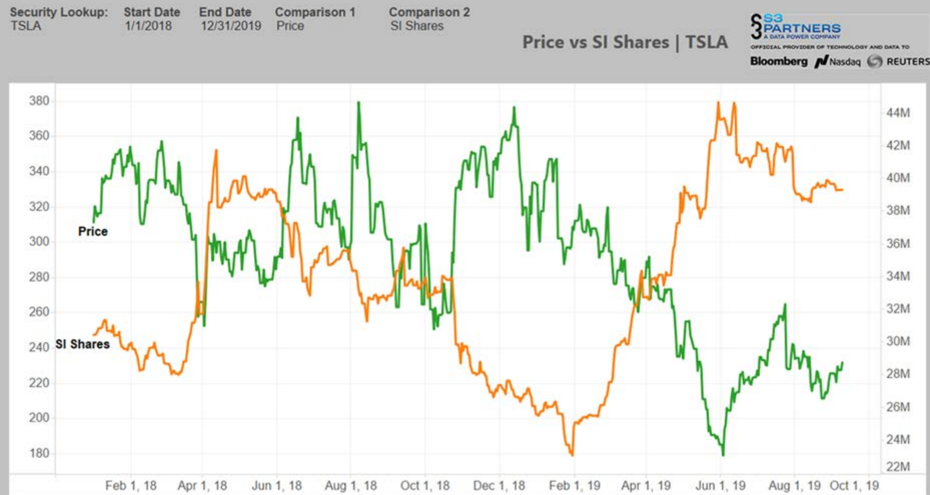
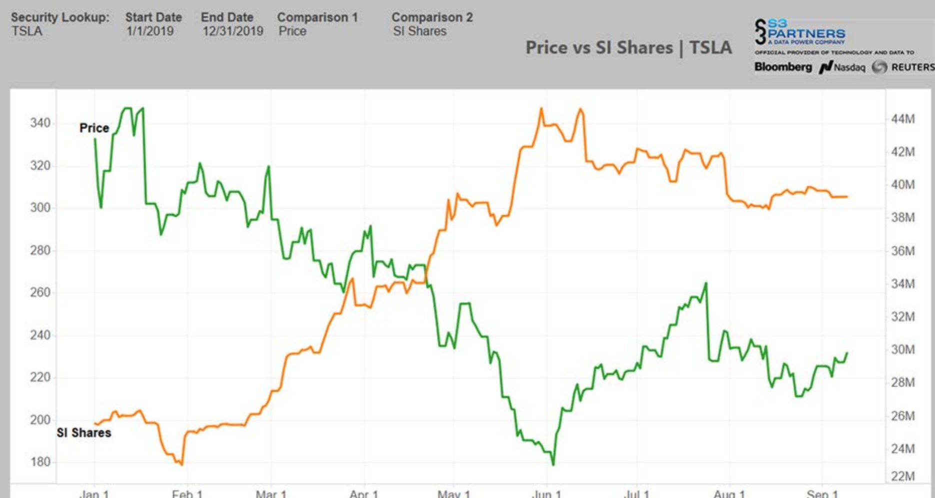


Figure 3



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A drive to maximise potential

Ronke Ayegbajeje of Stanbic IBTC discusses securities lending as a market catalyst

The concept of securities lending, which involves the transfer of securities from a lender to a borrower, based on agreed terms, is key to the financial sector as the presence and success of a securities lending market is a critical benchmark for measuring market quality and conduciveness for other differentiated products like derivatives.

Dating as far back as 1969, but formally commencing in London around 1999 before gaining popularity in other parts of the world, securities lending is more popular in Europe, some parts of Asia, and North America, with North America doing about 9 percent of world trade. According to the International Securities Lending Association (ISLA) as of 31 December 2018, a total of €2.2 trillion was on loan globally, while €16.6 trillion was available for lending.

Typically, lenders are institutional investors—pension fund administrators, insurance companies, fund managers, hedge funds, and asset managers; or individual investors—high net-worth individuals and retail investors. Additionally, fund managers who engage in securities lending have the potential to improve their fund portfolio performance by reinvesting the income earned in the fund or using it to offset management fees.

Institutional investors may approach a securities lending agent directly to make their securities available for lending while individual investors will do so through an intermediary agent. Parties that play as borrowers include stockbrokers, broker dealers and banks. Most markets have variants of the principal or agency lending models which they align with, depending on the regulations of such markets.

Benefits of securities lending from a participatory standpoint include the opening-up of additional streams of income to both the lender and borrower. Borrowers earn profit from short-selling and taking advantage of arbitrage opportunities while lenders earn income from fees paid by the borrowers. It also brings about market liquidity and drives price discovery. Like most loan agreements, collateral will be involved in the process—hence collaterals are quite critical for securities lending agreements. The collateral is to buy back the securities borrowed in case the borrower defaults, hence protecting the lender and returning them into a state where they were before the securities were borrowed. Collateral types for securities lending include, but are not limited to, cash, bonds, treasury bills, and other money market and debt instruments. Given the importance of securities lending in global markets, the use of the Global Master Securities Lending Agreement has become a standard that most markets adopt.

Curiously, given all its benefits, many regions in the world are yet to embrace the potential of securities lending. Except for South Africa,

the rest of Africa is yet to catch-up in the securities lending world. This financial invention is not only a catalyst for more sophisticated financial/capital market transactions like hedging, short selling, arbitrage which ultimately facilitate price discovery and brings about liquidity in the market; it is also the bedrock of many other financial market transactions like derivatives, forwards and so on. A market that is yet to offer securities lending I deem unequal to its securities lending offering counterparts in terms of market development and may not be as forward-looking.

Perhaps one of the reasons that this has not been fully embraced in many African countries and indeed some other parts of the world is that a few people understand the concept. This poor understanding is common to the parties who are supposed to play significant roles in securities lending—holders of securities, government regulators and tax authorities, who may find it challenging to apply tax rules. In some instances, the tax rules do not exist.

One way to remedy the issue of knowledge gap is for fund managers to sensitise security holders in their books and advise them of the opportunities of securities lending and benefits thereto. If this is done at the point of onboarding each client, then a sizeable amount of security holders will be duly informed, and we can expect to start closing the knowledge gap one step at a time.

Another considerable reason is the double taxation of dividend in some jurisdictions. This will happen when a corporate action event such as cash dividends are paid, the holder of the security (that is the borrower) receives the dividend but because the lender must be returned to their original position, the borrower will pay the proceeds from the dividend to the lender. The cash the borrower pays the lender in lieu of dividend received ('manufactured' or 'as is' dividend). While the original dividend paid to the borrower is subjected to a dividend tax rate. The manufactured dividend is also subjected to tax, nevertheless at a less favourable income tax rate by the government or tax authorities in such regions because they view the manufactured dividend as normal income from the business. This is discouraging to market makers and may even be viewed as punitive by some financial dealers.

The solution to this is for these governments/tax authorities to come up with policies favourable to manufactured dividends. Perhaps if these policies are imbibed worldwide, the global income from securities lending will surge significantly and securities financing will gain more popularity.

Investors have different personalities and appetite for risk, but as with any loan agreement or transaction, securities lending carries default risk. From history, the risk is controlled effectively through collaterisation of the transaction. Plus, some securities lending agents indemnify their lenders to prevent them from suffering losses.

There is also the risk that the borrower's collateral will be mismanaged by the lender or the securities lending agent, but there have been recent laws to combat this and government regulation in major countries allow lenders to re-invest collateral in sovereign bonds which are relatively risk-free.

To conclude on how effectively securities lending risks and perceived risk are being mitigated, the International Securities Lending Association has come up with a global agreement that governs all securities lending transactions. The agreement addresses defaults, lender and borrower warranties, collateral agreements, taxes and so on. This should encourage savvy investors.

Financial transactions are not usually done in isolation (except they are fraudulent) and will normally involve several parties. Securities lending is not an exception; hence, for it to work, world financial corporations, exchanges and depositories must work together to drive it to its full potential.

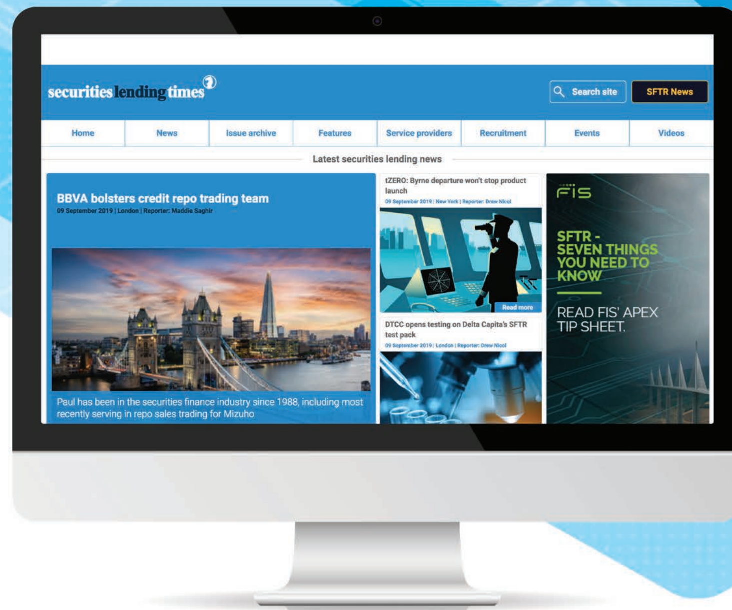
Although some parts of the world are yet to fully embrace securities lending, there are organisations that are determined to make it work by pushing, advocating and sensitising. One such organisation is Stanbic IBTC Bank in Nigeria (a member of Standard Bank Group), which is determined to pioneer this development in the Nigerian market and has worked closely with the Nigerian Stock Exchange, the Federal Inland Revenue Service—Nigeria's tax authority, and the Securities and Exchange Commission to ultimately add value to investors and the greater society.

Stanbic IBTC is technology-driven and has begun the process of driving the securities lending business technologically by engaging with the Nigerian Stock Exchange and the Central Securities Clearing System on processes to make each transaction straight-through. Fortunately, these organisations are very keen on bringing development to our markets and are working together to ensure this is attained.

Just as little drops of water are believed to form an ocean, I believe the efforts of these organisations will eventually pay off and can only hope that the rest of the world come to the table.

Ronke Ayegbajeje
Investor services
Stanbic IBTC

securities lending times



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Comings and goings at Credit Suisse, BNP Paribas and more

RBC Capital Markets has hired David Brand from Morgan Stanley to join its central funding team as a managing director based in London.

Brand spent the past 15 years with Morgan Stanley and was most recently the global head of sales for its bank resource management division, the unit housing the bank's securities lending, repo and listed and over-the-counter derivatives collateral businesses.

Prior to Morgan Stanley, Brand worked at Deutsche Bank for eight years between 1995 and 2003 in various roles across trading and sales.

John Paul has joined Banco Bilbao Vizcaya Argentaria (BBVA) UK in London as director of credit repo trading.

BBVA is a multinational Spanish banking group, which is also present in North America, South America and Turkey.

Paul has been in the securities finance industry since 1988, including most recently serving in repo sales trading for Mizuho since 2010.

Prior to Mizuho, from 2009, he was a repo broker for Global Credit Securities. Before that, Paul was with J.P. Morgan from June 2008 through to December 2008, as a director in repo trading.

During this time, he took over the French government repo book and was also responsible for covering the government bonds book.

In his early career, Paul worked at Bear Stearns for more than 10 years, between 1994 and 2008, in various roles before eventually becoming the director of repo trading.

Northern Trust has brought in fresh blood for its capital markets business to respond to a growing demand for its solutions globally and establish a transition management presence in Sydney.

Northern Trust's capital markets desks also provide trading and execution services on behalf of institutional clients, including securities lending, foreign exchange and institutional brokerage.

Northern Trust's new transition management desk is led by newcomer Mat Cook, who has joined from State Street to manage the bank's services for Asia-Pacific from its Sydney office.

Cook has worked as a transition manager for State Street since 2010.

Ben Jenkins, global head of transition management at Northern Trust Capital Markets, said: "Establishing our transition management footprint in Australia further extends our global capabilities."

"Today's uncertain, often complex environment means our clients require sophisticated, bespoke solutions for their portfolio transitions. With trading desks in Chicago, London and now Sydney, Northern Trust is ideally-placed to support our clients' strategies ever more closely–in their home markets and globally."

Elsewhere, Rob Dixon also made the move from State Street to join the Northern Trust's capital markets business in London in December 2018. In his new role, Dixon will support the bank's clients across Europe, the Middle East and Africa.

He was previously based in State Street's Sydney office as a transition manager, with responsibilities across Asia Pacific, from 2014 to 2018.

Between 2007 and 2014, Dixon worked at Mercer, BNY Mellon and Citi respectively as a transition manager.

In August, Northern Trust's Sydney office was also bolstered by the arrival of Grace Hayman, who was promoted to senior relationship manager for the bank's securities lending business in Australia and New Zealand.

BNP Paribas hired Adam Kings as a senior agency lending trader based in London, according to a source at the bank.

Kings joins from Citi where he was a securities lending trader, also based in London.

He was with Citi for just over 12 years having joined in a trade support role in 2007 before joining its securities lending desk in 2010.

BNP Paribas declined to comment on the appointment.

Credit Suisse has welcomed Joshua Barard to its prime sales team in Hong Kong.

Barard previously worked at ICAP, part of TP ICAP group, a markets operator and provider of execution and information services.

He joined ICAP in June 2016 and initially served in voice broking during a summer internship before starting his graduate scheme in voice broking in September the same year.

In 2017, Barard relocated to ICAP's Hong Kong office to serve as a structured products broker.

Barard also brings experience from roles with Lloyds Banking Group, where he was an independent contractor and then a special investigations analyst between 2014 and 2016.

Pierpoint Financial Consulting has brought on former Bank of America Merrill Lynch managing director Raymond Blokland as consulting lead for the Benelux region.

Pierpoint is a boutique consultancy focused on securities finance and collateral management, providing independent advisory services to a broad range of market participants including buy-side, sell-side and vendors.

Most recently, Blokland has operated as a securities finance and prime brokerage consultant based out of Rotterdam since November 2017.

Blokland, who will now be based in London, brings experience from two stints with Merrill

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Lynch, both as managing director. He first joined the bank in 2010 and served until 2014, before moving to 4sight Financial Software to become director consulting.

He later re-joined the bank in 2015 and stayed until 2017.

In total, Blokland offers 25 years of experience on both the buy-side and sell-side, almost all of it based in The Netherlands and Luxembourg.

Blokland commented: "My experience in the securities finance world can roughly be divided into two periods with almost equal length in time. One being on the buy-side by working with one of the largest European asset managers. The other on the sell-side as part of the securities finance and prime brokerage business units."

"Both periods have given me full perspective on the entire chain of events from supply to demand. Especially when I started to work for the sell-side, it has given me a knowledge of market drivers which are simply not visible to most beneficial owners."

Commenting on the latest hire, Pierpoint founder and practice lead, Roy Zimmerhansl, said: "Raymond Blokland's experience and contacts in the Benelux region adds tremendous value, particularly given our beneficial owner focus."

Blokland's appointment follows closely behind that of former global head of securities lending at BNP Paribas Securities Services, John Arnesen, who joined in August to oversee the firm's consulting operations.

Before that, the firm also gained Andrew Howieson, who joined as research partner in early August.

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.

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CloudMargin gains business development chief

CloudMargin has promoted Karl Wyborn to the newly created role of global head of business development, as part of plans to overhaul its sales operation and team.

Wyborn has spent the past four years as CloudMargin's global head of sales in charge of marketing and sales strategy, team development and global sales targets.

Based in London, Wyborn will now undertake responsibility for all business development strategies at the collateral and margin management solutions provider.

In addition, Wyborn will communicate with CloudMargin's partners, regulators, and other technology vendors concerning post-trade services.

CloudMargin CEO, Stuart Connolly, confirmed that he also intends to grow the sales operation and team over the next several months but could not share further details on the plans at this time.

Commenting on the appointment, Connelly said: "Wyborn's deep industry knowledge, outstanding experience and passion for CloudMargin's mission will be a tremendous foundation for the position, particularly as we start to build the next generation of solutions to meet the ever-increasing challenges our clients and partners are facing."

Wyborn added: "I jumped at the chance of this role when it was offered. The opportunity to leverage my prior experience in sales, marketing and product to be able to help shape the future strategic direction of CloudMargin holds enormous appeal for me."

Wyborn originally joined CloudMargin 2015 from NetOTC where he was head of business development and relationship management for just over a year.

Before that, he served at JPMorgan Chase as head of sales and relationship management for clearing, custody and collateral services for Europe, the Middle East and Africa between 2011 and 2014.