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Issue 253 26 May 2020

Canada thrives

No markets are immune to COVID-19 but some are better equipped to manage volatility than others, and very few are as safe as Canada

Panel Discussion

Leading figures from the country's securities lending market offer an update on the key issues of the moment

New Normal

Lenders seek to strike the right balance between ESG principles and revenue optimisation

False Positive

Kaizen Reporting warns firms preparing for SFTR reporting that valid data doesn't necessarily mean accurate data

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CME to close NEX Regulatory Reporting

The closure of NEX Regulatory Reporting (NRR) and Abide services will have a "far-reaching impact on the regulatory reporting community and industry at large," warns Cappitech CEO Ronen Kertis.

On 15 May, CME informed its clients that it would be winding down most of its regulatory reporting services by 30 November, including NRR and CME's European and Australian trade repositories (TR).

NEX's Abide regulatory reporting and TR product suite is also set to close its doors at the same time.

CME will retain the US (CFTC) swap data repository and Canadian trade repository services.

SLT understands that CME has spent at least the past six months unsuccessfully attempting to sell the businesses before it decided to begin the termination process.

CME declined to comment on the attempt to sell the businesses but a spokesperson notes that the decision to wind down was made "following an evaluation of our business portfolio after the acquisition of NEX Group in November 2018 which determined it no longer aligns with the strategic direction of CME Group".

Regarding the members of staff working across these businesses, the spokesperson explains that a consultation process with impacted employees is "ongoing" as there are roles at risk of redundancy.

The exact number of jobs at risk is not currently known.

The announcement may come as a surprise to some clients as SLT further understands that NRR was still onboarding new users of its Securities Financing Transactions Regulation (SFTR) reporting services until "very recently", according to a source with understanding of the matter.

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CME to close NEX Regulatory Reporting

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As part of its effort to ensure a "smooth transition" of its clients using these services, including those recently onboarded, CME says it "expects to continue to process SFTR records through the wind-down period but there will be no further development on SFTR".

As a result, CME is encouraging its clients to "find alternative solutions as soon as possible".

CME further confirms it will not be charging for SFTR services and will assist firms where it can with their transition to another provider.

Phase one of SFTR went live in April but its reporting requirements for those in-scope do not kick in until July as part of phase two. Therefore, any firms expecting to fulfil their reporting obligations via NEX's solution will now have to scramble to align themselves with a new service provider with only a few weeks to go.

In response to news of the wind down, Cappitech's Kertis says the closure will have left the market and CME's clients with "real concerns regarding consistency of trade reporting and their ability to transfer to a new TR/approved reporting mechanism (ARM) with as little impact on their individual businesses as possible".

He adds that "in the current COVID-19 environment, and with a relatively short timeline to find alternative providers, this is potentially even more challenging, particularly as regulators are likely to expect dependable and high-quality trade reporting to continue throughout".

Those now forced to find a new TR/ARM face the "daunting task" of porting data correctly without opening themselves to potential reporting faults and fines, Kertis explains.

"The trade reporting industry will miss CME in Europe where they have long been an important part of the market," he notes. "Their commitment to working with vendors, clients and other TRs to smooth the transition will be an important part of this process, facilitated by existing partnerships and relationships."

In terms of CME's outgoing TRs, its European TR was licenced under the European Market Infrastructure Regulation but not the Securities Financing Transactions Regulation, having withdrawn its application in 2019.

Under EMIR's rules, CME clients will need to port all positions, not just open ones, to the new TR. This challenge will be made more complex still with EMIR Refit due this Summer.

ISLA's sustainability council calls for global consistency on ESG guidance

The International Securities Lending Association's Council for Sustainable Finance (ICSF) is calling for "holistic guidance" on any measures that may "significantly affect sustainable securities lending".

The council's efforts come in the form of its second position paper 'Reinforcing Global Sustainable Finance by Improving Guidance on Securities Lending', where it seeks to move beyond discussions of short selling that have been one of its main focus areas until now.

ICSF's first paper presented a plethora of academic evidence that the short selling bans that came in the wake of the market

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disruption in March were not fit for purpose. The bans in Europe have since been lifted.

In its new paper, ICSF continues to shine the spotlight on the issues that arise from global inconsistencies in how national regulators are interpreting and applying rules on sustainable financing.

To remove this hurdle, the council seeks to create guidelines that would establish a "consistent global approach" to various measures that may impact upon sustainable securities lending.

ICSF recommends that measures be evidenced-based, proportional, aligned with its voluntary guidelines known as the Principles for Sustainable Securities Lending.

The process of creating the guidance, ICSF says, should involve informing the key stakeholders regularly about the market participants' behaviour, and (crucially) be subject to continuous review.

To further this aim, ICSF will convene an initial roundtable "in the near future" and is calling on ISLA members to voice their interests in contributing.

Dividend arbitrage under the spotlight in EBA inquiry

The European Banking Authority (EBA) has grasped the nettle that is dividend arbitrage by publishing the results of its two-year enquiry into the infamous Cum-Ex/Cum-Cum trades.

The securities lending community has long grappled with the legal and moral grey area presented by Cum-Ex/Cum-Cum trades and has spent recent years shaking off accusations that facilitating the borrowing of equities over dividend periods could open the door to bad actors.

The spotlight was first put on Cum-Ex trades in the EU – specifically Germany – following the revelation in 2012 that a legal loophole in dividend payments could be exploited to allow more than one party to claim a tax refund on the same asset.

Criminal law firm Rahman Ravelli Solicitors estimates that the scandal cost the German treasury €10 billion in lost revenue and suggests that there may be more than 10 other European countries affected, representing a further €55 billion of lost tax revenue.

In 2019, the German authorities, which since the scandal broke has been leading the charge in clamping down on those seeking to cheat the taxman, conducted police raids the offices of ABN AMRO and Clearstream, as well as the homes of traders, as part of its campaign against market abuse.

ABN AMRO's offices were raided for a second time in February for similar reasons, according to a report by Bloomberg.

Both firms stated at the time of the raids that they were fully cooperating with authorities on the matter.

In March, two former London-based traders were convicted in Germany of tax evasion related to Cum-Ex trades.

In part, the connection with these events and securities lending is due to dividend arbitrage being a notoriously misunderstood trade type outside those few traders that conduct them.

As a result, the negative perceptions and suspicion driven by headline-grabbing examples of arbitrage being used for tax evasion by a few traders have led to

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securities lending being tarred with the same brush.

This issue is highlighted prominently in the EBA's report on dividend arbitrage schemes which looked into the actions of prudential and anti-money laundering (AML) and countering the financing of terrorism (CFT) supervisors in dealing with such schemes.

The EU regulatory agency says its study shows that national authorities do not share the same understanding of dividend arbitrage trading schemes, due to differences in member states' domestic tax law.

The EBA concludes that facilitating, or handling proceeds from tax crimes undermines the integrity of the EU's financial system.

To mitigate this issue, the EBA has set out a list of expectations of credit institutions and national authorities under the current regulatory framework.

These expectations come in the form of a 10-point action plan for 2020/21 to enhance the future framework of prudential and AML requirements covering such schemes.

The EBA says the action plan seizes on the opportunities afforded by recent legislative changes in the EU Capital Requirements Directive and the EBA's AML/CFT mandate in the EBA regulation, which will be implemented in this year and next year.

The points are largely aimed at stamping out the lingering ambiguity around such schemes and includes a requirement for the policies implemented by institutions to set out principles on, and provide examples of, acceptable and unacceptable behaviours linked in particular to misconduct and financial crime.

Commenting on the report, Roy Zimmerhansl, practice lead and founder of Pierpoint Financial Consulting, tells SLT that it highlights "an area of nagging concerns for both lenders and non-lenders".

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"The eventual outcome is that national competent authorities and tax authorities will have scoured the activity in their markets, scrubbed clean any abuse they find and participants are on notice that their oversight will be under scrutiny.

"Just like the period after the short selling bans in 2008/2009 led to more countries encouraging short selling and fewer countries implementing bans this time around, I expect these inquiries to lead to general discomfort, followed by more openness and a bigger, more transparent market in future.

"These ructions are adjustments along the way, but ultimately help ensure the longevity of securities lending. The legacy opacity of the business has held it back in some corners."

The EBA's enquiry was the result of the European Parliament tasking the European Securities and Markets Authority (ESMA) and the EBA with investigating dividend arbitrage trading schemes in November 2018 to assess potential threats to the integrity of financial markets and to national budgets.

The study further sought to establish the nature and magnitude of actors in these schemes; to assess whether there were breaches of either national or EU law; to assess the actions taken by financial supervisors in member states; and, to make appropriate recommendations for reform and for action to the competent authorities concerned.

The EBA fulfilled the request by submitting two surveys to national authorities, and using the responses to create its action plan. Point 10 of the action plan includes conducting a fresh inquiry in the future to monitor how national authorities are getting on in stamping out bad practices.

Europe cured of short selling bans

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unilaterally decided to not renew their respective short selling bans, which expired 18 May.

Meanwhile, Italy's CONSOB had intended to maintain its restriction on shorting until 18 June but has now terminate d it early to align with other European markets.

The restrictions on new short positions were a symptom of the COVID-19-inspired market turmoil that saw the regulators scramble to pull markets out of free-fall in early March.

The decision not to renew means that, as of 19 May, the EU will be free of short selling bans for the first time since 13 March, when Spain enacted a one-day ban in response to increased market volatility brought on by the disease's spread through the continent.

The spate of short-term bans in Italy, France and Spain in March was later extended to month-long prohibitions on new short positions being taken as the pandemic took hold.

Italy, which is among the countries worst affected by the coronavirus both socially and economically, opted for a three-month ban.

The curbs on short selling prompted a major backlash from several corners of the financial world including the International Securities Lending Association's Council for Sustainable Finance, the World Federation of Exchanges (WFE), and the German investment funds association, among several others.

The consortium of critics stated that such bans were proven to distort price discovery and undermine market liquidity.

A less likely ally for short sellers was the UK's Financial Conduct Authority (FCA) which not only refused to follow suit with its continental counterparts but openly disputed whether the bans are an appropriate action.

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The FCA said in March that its research into the consequences of the bans imposed by itself and others during the height of the 2008 financial crisis showed it did more harm than good in the long run.

Despite the widespread criticism, all the EU regulators that laid down bans in March renewed them for a further month in April.

Now, they say the calmer market conditions make the restrictions are no longer necessary. WFE was among the first to celebrate the regulators' decision.

In a statement, WFE says it welcomes the decision to end the short selling bans across Europe and "commends authorities' efforts to return to normal operations of fair and orderly markets in the region".

Elsewhere, ISLA CEO Andrew Dyson also hailed the return to normality. "As markets have returned to something of normal reality, it is encouraging to see that regulators across Europe feel there is no immediate need to extend these bans further," Dyson tells SLT.

"Whilst the effectiveness of short selling bans continues to spark debate, there is no doubt that by allowing investors to engage more broadly in short selling activity, an important part of market liquidity will have returned to those markets subject to these bans."

In March, the European Securities and Market Authority (ESMA), which has been stuck in the middle of the row, opted to endorse the individual market bans but resisted calls from the EU's political sphere to enact emergency powers to place an EU-wide blanket ban on shorting.

The EU securities market watchdog did however take steps to lower the disclosure threshold for net short positions from 0.2 percent to 0.1 percent on 16 March, in a move aimed at increasing market transparency.

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The measure will remain in place until 16 June when the need for its renewal will be reviewed.

Delta Capita collaborates with DTCC on buy-side firms' SFTR Testing

Delta Capita, the international business and technology consulting and managed services firm, has extended its collaboration with the Depository Trust and Clearing Corporation (DTCC) to help market participants meet their Securities Financing Transactions Regulation (SFTR) trade reporting requirements.

Buy-side firms will be required to report SFTs from 12 October as part of the third implementation phase of SFTR.

Through the collaboration, clients of DTCC's Global Trade Repository (GTR) service for SFTR will be able to directly leverage Delta Capita's buy-side data test pack, in order to streamline the testing process, says Delta Capita.

The test pack has been developed with a consortium of banks and agent lenders and is now available for asset managers, hedge funds and other buy-side firms for their SFTR testing.

Clients of DTCC's GTR service who use the test pack will have access to SFT life-cycle event test scenarios, including the expected results, to help identify issues and accelerate testing ahead of SFTR go live.

The pack comes with an online traceability module, linking SFTR test cases to the regulatory and industry technical standards, and the European Securities and Markets Authority (ESMA) rules and best practice.

Firms can also benchmark their testing progress within their peer group.

David Field, head of the securities finance practice at Delta Capita, says: "Firms using

the test pack will benefit from an enhanced testing data set, reducing testing effort, so testing is faster and less expensive, but at the same time, more robust."

Valentino Wotton, managing director, product development and strategy, repository and derivatives services at DTCC, adds: "As buy-side firms progress with preparations in order to meet forthcoming SFTR trade reporting requirements, testing will be an important milestone."

Eurex STS and Access Fintech partner on CSDR

Deutsche Boerse's buy-in agent, Eurex Securities Transactions Services (Eurex STS), has partnered with Access Fintech to create integration between their Central Securities Depositories Regulation (CSDR) services.

CSDR aims to improve settlement rates in securities markets by imposing punitive measures on firms that fail to settle trades and is due to come into effect in February 2021.

Access Fintech offers a solution that aims to allows clients to manage the entire lifecycle of transactions.

By using this alongside its other live settlements product, Access Fintech says clients can manage CSDR's penalties better. Meanwhile, Eurex STS provides a neutral marketplace for buy-ins to be completed. Through the new partnership, mutual clients can manage buy-ins via Eurex STS through the Access Fintech infrastructure.

"While clients will be able to connect to our platform directly, some also require further connectivity choices," a Eurex spokesperson says. "In this respect, we are working with Access Fintech to discuss and analyse the possibility of our two platforms communicating with each other through our application programming interface."

Meanwhile, Pardeep Cassells, head of financial products at Access Fintech, tells SLT: "Access Fintech [is] extremely excited

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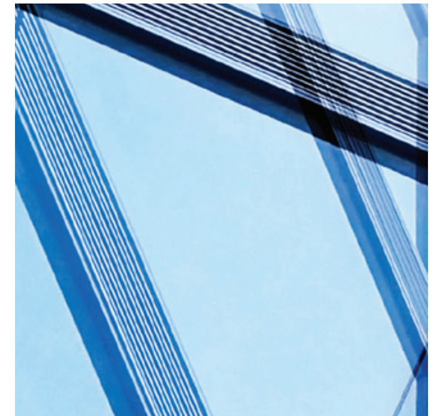

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Market and economy decoupling

The European Securities and Markets Authority (ESMA) has released its first complete risk dashboard for 2020 in which it "sees potential decoupling of financial market performance and underlying activity".

I agree. In an apparent repeat of 2008, to borrow a phrase, we appear to have entered a "new normal". The real economy has contracted more sharply and deeply than at any time in living history. Right across the full ambit of economic indicators the economy is on life support, yet, buoyed on by unprecedented central bank intervention; monetary easing; and fiscal support, stock markets appear buoyant.

As I write, France and Germany have thrashed out a compromise. Their proposal is for a €500 billion recovery fund of grants (not loans) to be distributed to EU countries in need. Across the pond, while the Senate and the House differ on details, a total package worth $3 trillion is in the making.

Governments and central banks appear happy to stave off an economic depression by maxing out the national credit card thereby saddling future generations with high taxes and low public spending to work off their parents' debt.

History never repeats itself except in this new paradigm. Just like 2008, a deep recession is avoided while economic indicators nose-dive. As part of its global economic outlook report in April, the International Monetary Fund forecasted an unprecedented 3 percent contraction in global growth (6.1 percent for advanced economies; UK 6.5 percent; Euro-area 7.5 percent) yet asset prices remain elevated. We face a perplexing scenario where J.P. Morgan's predictions include "[the] S&P 500…recovering its losses and reaching 3,400 (new highs) in the first half of 2021", despite US April unemployment soaring to a post-Great Depression high of 14.7 percent. The Bureau of Labor Statistics posits that with necessary adjustments, the actual unemployment rate is closer to 23 percent!

A recession (but not a depression) appears inevitable but asset prices are set to rebound while unemployment and poverty will rocket. This is what commentators refer to as the market and real economy "decoupling". Put at its crudest, the rich (those with funds to allocate to assets) will enjoy bumper profits after the likely recession. There is ample evidence for rotation strategies being played out. Global investment funds outflow reached 25 percent in March 2020 as investors sought defensive save havens. The rest – sometimes referred to as 'the 99 percent' – (those without funds to allocate to assets) face high tax and job uncertainty if not unemployment.

With developed countries already grappling with the pernicious rise of populism, this does not auger well for societal cohesion. Moral hazard is set to be debated afresh if public funds result in private profit.

On a tangential point concerning securities lending and the backdrop of industry unease at the impending Central Securities Depositories Regulation (CSDR), equities settlement fails jumped to around 12 percent in March. With industry bodies unhappy with ESMA's mandatory buy-in regime to mitigate such failures, these poor figures will only embolden the regulator's stance.

ESMA noted that "[f]ails were reported to be mainly caused by operational rather than liquidity issues and were usually resolved within one to five days". Reading between the lines, it could be argued that ESMA appears to be firing back at industry complaint suggesting that poor practise rather than a lack of availability caused this poor performance.

Seb Malik
Head of financial law
Market FinReg

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ESG and securities lending can co-exist

Don D'Eramo
Global head of securities finance
RBC I&TS

Lenders seek to strike the right balance between ESG principles and revenue optimisation

The integration of environmental, social and governance (ESG) factors is an increasingly important part of investment strategies. Investors seek to exercise governance responsibilities by screening companies considered to be more responsible in their corporate behaviour, or focusing on those where voting rights can be used to exert influence.

ESG performance is also a growing consideration among beneficial owners as they endeavour to implement and adhere to guiding principles in harmony with the nuances of securities lending. This can also play into the timing and recall of loans. For example, when a security is out on loan, beneficial owners are required to close positions on loan in order to facilitate proxy voting as this entitlement transfers to the borrower.

The issue was recently brought to the forefront when Japan's Government Pension Investment Fund (GPIF), which aims to be a market leader in ESG financing, paused its equity securities lending programme late in 2019, noting that it "can be considered to be inconsistent with the fulfilment of the stewardship responsibilities of a long-term investor".

The International Securities Lending Association (ISLA) is also focused on ESG, including challenges around beneficial owners' collateral as well as the industry's association with short selling. In a recent blog post,

ISLA's CEO Andrew Dyson said the introduction of ESG principles into the securities finance market has created "an interesting natural tension" between the traditional rules-based approach and values or principles-driven strategies of sustainable finance.

"Reconciling these quite different worlds will present both organizational and cultural challenges across our markets and beyond," he wrote.

Fulfilling good governance

Regardless of the reasons GPIF had for stopping its securities lending programme, which went beyond proxy voting, lenders can still find ways to maintain their vote, says Donato D'Eramo, and managing director and global head of securities finance at RBC Investor & Treasury Services (RBC I&TS), and president of the Canadian Securities Lending Association.

"Securities lending can definitely co-exist with ESG governance given that one of the key tenets of securities lending programmes is their ability to meet clients' requirements," D'Eramo says. "For example, if you want to vote your shares at every annual general meeting, or on only a potentially contentious issue, the ability to recall your securities to vote is there."

The solution, according to D'Eramo, is for lenders to work directly with their agents to construct a securities lending program that fits their investment strategy and practices. Lenders should inform their agent ahead of the required voting date, so that lending positions can be returned. "It's all about the transfer of information and understanding what your client's lending objectives are," says D'Eramo.

The revenue consideration

Revenue is amongst some of the considerations for lenders when deciding whether to recall securities to vote, as it can limit earning potential – particularly with high intrinsic value loans. The decision to recall often comes down to giving up additional lending revenue to place the vote. "Sometimes there is a trade-off between revenue and governance objectives, said D'Eramo. "Every lender will have varying degrees as to how they want to enhance their corporate governance policy," he adds.

In many cases, lenders have internal guidelines that help determine when to vote, such as on important events related to performance, or based on ESG principles. A lender may leave securities on loan if the voting matter is not considered material to their overall performance.

"RBC I&TS takes a consultative approach with clients to determine the most suitable model of fulfilling their governance requirements – case-by-case or full mandate," according to D'Eramo, "while also striking a balance on revenue".

Going beyond voting rights

The discussion regarding ESG and securities lending goes beyond voting rights and may include restricting certain types of securities based on internal governance policies or certain types of collateral depending on internal ESG views. For example, lenders may see short-selling as inconsistent with ESG investing, since sustainable investing is often seen as a long-term investment strategy.

However, various studies have countered that argument. D'Eramo refers to a recent European Securities and Markets Authority (ESMA) report. "In December 2019, ESMA published its findings on 'potential undue short-term pressures in securities markets'. The report specifically noted that 'short selling and securities lending are key for price discovery and market liquidity'."

The agent's role is to translate the lender's mission and goals into a specific securities lending program, the same way it has for non-ESG issues. "We have been balancing this practice with clients for many years," D'Eramo says. "This is not a new process, but the enhanced focus requires more consultative client discussions to find the best approach for all."

Bespoke securities lending

Securities lending is not a one-size-fits-all approach. Lenders are looking for programmes designed to meet their specific needs and goals, which increasingly includes ESG factors.

As ESG continues to play a role in investment strategies, lenders need to balance performance needs with their responsible investing principles. It may be a trade-off between revenue and how material the vote is to the lender.

According to D'Eramo, it is possible to balance ESG-inspired lending approaches with the right strategies. "ESG is an increasing focal point in the investment industry at large, with downstream considerations for securities lending," D'Eramo says.

He recommends lenders find a "bespoke, well-thought-out securities lending program" to ensure their investing needs are properly met.

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Canadian strength and stability

Rob Ferguson
Chief capital markets officer
CIBC Mellon

CIBC Mellon's Rob Ferguson discusses Canada's securities lending market, and its continued strength and stability amid the global pandemic

What are you seeing in the Canadian securities lending market as a result of the financial downturn?

Canada's securities lending market continues to maintain its strong position as a global safe-haven market in turbulent times, particularly now amid the global pandemic. Buoyed by the strength, stability, maturity and transparency of Canada's financial and regulatory environment, and its continued AAA debt rating, Canada's securities lending market is still among the world's largest and most active.

Canada saw increased demand in both Canadian fixed income and equities. On the fixed income side, borrowers sourced high-quality liquid assets (HQLAs) – such as Government of Canada bonds and treasury bills (T-bills) – to shore up their liquidity needs. Demand for term-loans of HQLA jumped as borrowers looked to secure sources

of liquidity. Given the situation of tremendous volumes in Q1, most notably in March, and the Bank of Canada (BoC) auctioning record T-bill issuance, while we saw borrowers continuing to move to shorter-dated Canadian HQLA issues. We also saw beneficial owners increase their sales of HQLA to support their own liquidity needs. With the recent introduction of the first-ever quantitative easing programme by the BoC, we have seen the need for borrowing term HQLA start to ease.

Canadian equities also experienced a significant increase in demand. Canada, being a resource-based market, was particularly hit hard with the recent significant decline in oil prices. We saw demand spike in the energy and materials sectors, especially in the small-to-mid-cap space, as questions arose concerning the viability of some firms – if they can continue their operations. The Canadian equity market experienced its quickest turnaround from a bull to a bear and back to bull market in history, and we have since seen some stability and normalcy return to demand and volumes within Canadian equity. We also saw our balances jump in the Canadian equity space, while overall this area was flat. We continue to see the majority of participants remaining in their securities lending programs.

How is the BoC maintaining market liquidity during this period of economic stress?

It has been an extraordinary time globally, which has resulted in unprecedented market events and measures in Canada. The BoC acted decisively and quickly, using the lessons learned from the 2008 financial downturn.

In early March, as global markets were quickly adjusting to a correction, the BoC reduced its benchmark lending rate at a record-setting pace. In response to the COVID-19 pandemic and dropping oil prices, the BoC, in a series of emergency 50bps movements, reduced its benchmark lending rate by 150bps to 0.25 percent. Prior to those emergency measures, the BoC kept its interest rate unchanged at 1.75 percent since late 2018.

In addition to its rate cuts, the BoC launched its first-ever quantitative easing programme in which it buys Government of Canada securities, provincial and commercial debt in the secondary market to help address strains in the Government of Canada bond market, thereby supporting Canada's economy and financial system amid the major disruptions being experienced by COVID-19.

The programme expands the BoC's balance sheet by a minimum of CAD 5 billion a week through purchases in the secondary market and this is expected to total CAD 200 billion by the end of 2020.

The BoC's Commercial Paper Purchase Programme, which began on 2 April, supports the flow of credit to the economy by easing strains in Canada's commercial paper markets over a 12-month period. CIBC Mellon is proud to be the selected custodian supporting this BoC programme. In addition, there are several other stabilising measures in place that were launched in response to the pandemic and designed to support and uphold the stability of Canada's financial system. On top of that, the federal government has implemented emergency aid, fiscal stimulus packages and a tax deferral programme. In spite of this, at the time of going to press, Canada still maintains its long-standing AAA credit rating and is one of only 10 countries with this top credit status.

What do you see as some key themes facing the industry now and further into 2020?

The sectors most impacted by this economic slowdown – mainly the energy sector, materials, travel, airlines, and retail sector – are expected to continue to struggle and we plan to see continued securities lending demand in those sectors until we see an economic recovery on the horizon. Until we have that 'light at the end of the tunnel' clarity, we expect to continue to see those sectors pressured.

As a result of the increased market volatility recently experienced, we have seen some asset allocation shifts, due to market valuations and potential opportunities. For example, we saw some pension plan clients moving out of fixed income into equities. Furthermore, we expect the market correction will have many clients reviewing their portfolio composition and asset mix, as they reassess and rebalance their investments.

We continue to focus on collateral expansion as borrowers' collateral needs change and evolve more quickly than ever. We are also continuing to provide client education on the trade-off between collateral flexibility, revenue generation and risk, and maximising their risk-adjusted returns.

All in all, Canada's securities lending market can be expected to continue as a stable bright spot for lenders and borrowers, offering new opportunities along with the strength, stability and resiliency of the Canadian financial market.

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Beware of valid but wrong SFTR reports

Jonathan Lee
Senior regulatory reporting specialist (SFTR)
Kaizen Reporting

Kaizen Reporting warns firms preparing for SFTR reporting that valid data doesn't necessarily mean accurate data

Many services have come to the fore ahead of the Securities Financing Transactions Regulation (SFTR) go-live, offering everything from trade matching, reference data enrichment to assisted reporting services. Securities financing businesses have historically been subject to very few regulatory reporting obligations, rarely abide by standards and are often quite firm-specific operations with a focus on collateral management and settlement efficiency rather than the finer details of individual transactions necessary for reporting.

The regulation has certainly inspired a desire to implement standards and bring industry participants closer together in areas such as user acceptance testing (UAT). A consortium has sought to help firms capture the complete scope of their businesses and the UAT testing necessary to try to ensure completeness of SFTR reporting. Furthermore, in an attempt to give comfort around progress with SFTR project plans, operating models have been reviewed and benchmarking put in place. This has provided something of a jump-

start for firms that were struggling to get their SFTR plans firmly off the ground.

Look out for valid but wrong reports

Completeness of reporting and ensuring that reports are compliant with validation rules are both vital but it's far from the whole story. Unfortunately, validation rules are very far from foolproof, with some significant holes. They also do not ensure that valid data (field populations that meet the conditionality and syntax rules) is correct data. Standardised test packs and a consortium approach to UAT testing is a very useful SFTR implementation tool but it simply doesn't go far enough to ensure that data quality has been established or maintained once SFTR is a live reporting regime.

Our wealth of experience in testing existing G20 position and transaction-based reporting regimes such as the second Markets in Financial Instruments Directive's transaction Reporting, the European Market Infrastructure Regulation or the US Dodd-Frank Act indicates that many reporting counterparties routinely submit reports that are valid but wrong. Indeed, the vast majority of fully validated transaction reports we test exhibit multiple errors, what we call the "valid but wrong problem".

Why SFTR, why now?

EU regulators have built SFTR to meet a dual-purpose mandate. Firstly, to provide an aggregated macro view of SFT market system, counterparty and collateral risks to share with both European and global regulators. Secondly, the reports are required to support investigations regarding market abuse and any market or credit events involving a reporting entity. They have chosen not to use golden sources of reference data themselves, instead reliant upon the pricing, interest rates, party to a transaction and security classification data provided by reporting parties. Two-sided reporting is required to prevent double-counting but also to try to ensure that risks are classified correctly.

Trade matching, assisted reporting and delegated reporting that attempt to make two-sided reporting function more like single-sided reporting will often mask issues with data quality, as the old saying goes "two wrongs do not make a right". Under SFTR, national competent authorities (NCAs) are required to enact penalties for reporting infringements that are effective, proportionate and dissuasive. They will not hesitate to do so if poor quality data is thwarting their macro or micro surveillance efforts.

Getting it right

Adopting frequent, periodic accuracy testing, pre-go-live and on an ongoing basis is really the only sure-fire way of obtaining quality assurance around your SFTR reporting at the point of implementation and into the future for this fast-evolving business. Deploying accuracy testing will also give operations teams greater confidence in responding to trade repository reconciliation feedback, without the need to conduct detailed investigations into their own reports in many cases both saving time and money.

Kaizen's approach to regulatory testing for SFTR is very different. We take a holistic perspective to a firm's reported data with an initial focus on the primary source of reporting errors - the accuracy of data contained within the reports submitted to a trade repository. This universal testing approach involves applying tests across every record and every one of the 155 fields and four reporting tables, every SFT transaction type and all 10 action types.

Our methodology has been designed to provide full coverage, giving greater confidence to senior management and regulators alike that the reporting issues have been surfaced. With regular testing, firms can know that the testing that is applied is consistent with the business practices and products and any new regulatory requirements published by the European Securities and Markets Authority as well as industry practice.

Jonathan Lee
Senior regulatory reporting specialist (SFTR)
Kaizen Reporting

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Canadian securities lending

Leading figures from Canada's securities lending market offer an update on the key issues of the moment, including collateral changes, cannabis short interest and adapting to an environment with COVID-19

Panel participants

Lisa Tomada, vice president, global securities lending, CIBC Mellon
Kyle Kolasingh, associate director, securities finance, RBC Investor & Treasury Services
Alexa Lemstra, head of EquiLend Canada
Katie Pries, president and CEO, Northern Trust Canada
Nick Conroy, director, head of Canadian securities lending, Scotiabank

To deal with the global pandemic, central banks have joined forces to maintain liquidity during this period of volatility. How has the Canadian securities finance market fared compared to other markets?

Lisa Tomada: In terms of securities lending, the majority of global markets have fared well, including Canada. High-quality liquid assets (HQLAs) have been at the centre of activity from both borrowers and beneficial owners. Borrowers sourced HQLA to shore up liquidity needs and were especially looking for term loans of HQLAs in order to secure sources of liquidity. Beneficial owners increased sales of HQLA to meet their own liquidity needs. With the addition of the quantitative easing programme by the Bank of Canada into the market, we have seen the need for borrowing term HQLA start to ease.

Canadian equities also experienced a spike in demand. Canada, being a resource-based market, was particularly hit hard with the recent crash in oil prices. From a securities lending perspective, demand in our programme spiked in the energy and materials sectors. We have since seen some stability return to demand and volumes within the Canadian equity space. Overall, the Canadian equity market was down due to negative market valuations.

Alexa Lemstra: The Canadian market felt the impact of this global event in much the same way that other markets did. Looking at DataLend for an overview of what happened, from an inventory, on loan and utilisation standpoint, the trends in Canada are very similar to the US and the global impact of the pandemic.

Canadian lendable and on-loan saw a general downward trend from the end of February through the end of March, with lendable value dropping 20 percent. Utilisation increased in both the Canadian and US Markets, from about 11 percent to over 13 percent in Canada from February to March and from under 10 percent to over 13 percent in the US during the same period. Each market has its own nuances, but generally, the Canadian market trends were in line with global markets.

Kyle Kolasingh: Given the COVID-19 pandemic and accompanying global market turmoil, 2020 is turning out to be an extraordinary year for the securities lending industry. Actions taken by the world's central banks added an element of economic stability although ongoing market volatility continued to impact the securities finance sector.

In Canada, we witnessed a significant increase in investment activity on the part of beneficial owners during March and April. Some lenders also realigned their securities finance programme parameters in order to adjust their risk-based investment strategies. While this combination of events resulted in a number of challenges for agent lenders, it also created an opportunity for beneficial owners as the securities lending market experienced an influx of transactional activity.

For example, one of the asset classes most impacted by the situation was HQLA as investors sought to create liquidity amidst the volatility. This sudden increase in sales activity translated into a temporary tightening of supply in the lending market and higher lending fees, particularly advantageous to those lenders who took part in duration structures (term lending).

Katie Pries: Overall demand remains strong for securities lending in Canada with spreads and utilisation off slightly from last year's pace. Canada

Lisa Tomada
Vice president, global securities lending
CIBC Mellon

Canadian equities also experienced a spike in demand. Canada, being a resource-based market, was particularly hit hard with the recent crash in oil prices.

Kyle Kolasingh
Associate director, securities finance
RBC Investor & Treasury Services

While recent events resulted in challenges for agent lenders, it also created an opportunity for beneficial owners

is coming off an exceptionally good year in 2019, where the main drivers of securities lending revenue were HQLA trades (Canada government debt) and high demand (specials) equity such as cannabis stocks. In 2020, those same trends continue with added volatility associated with the global pandemic. Canada has not imposed short sale bans like ones seen in Europe which has allowed Canada's market to maintain active trading and hedging. Securities lending activities continue relatively uninhibited.

In addition to demand for HQLA and specials, as the result of current market volatility exchange-traded funds (ETFs) have become a prime source of liquidity and demand within the securities lending market. ETFs serve the purpose of providing liquidity for a variety of trade strategies, whether targeted at the broad market or a specific industry sector.

Nick Conroy: The actions of central banks to maintain liquidity in their domestic markets, as well as the strong coordination between them, has played an important role in easing strains in global funding markets during the COVID-19 pandemic. Lower interest rates and large scale asset purchase programmes have injected significant liquidity into global markets and our observation has been that the securities finance market has shown incredible resiliency during this period.

Throughout this volatile period, the stability of the Canadian market has been on display. We've seen intervention in certain parts of the world with steps such as imposing short-selling restrictions. In Canada, it has largely been business as usual with strong client demand and a greater willingness to put cash to use.

Last year, CASLA and other stakeholders were working with regulators on reforms for NI 81-102, which currently limited mutual funds' ability to accept equities as collateral. What's the latest there?

Kolasingh: Similar to US '40-act funds, current regulation limits the scope of eligible collateral for mutual funds under Canada's National Instrument 81-102. As the lending market continues to experience a lack of specials compared to recent years, the ability of lenders to utilise the full range of collateral is essential to revenue optimisation. Levelling the playing field across all categories of beneficial owners is key to enabling such optimisation. The mutual fund industry is facing a highly competitive environment with significant pressure to reduce fund expenses.

Securities lending plays an important role in facilitating cost reduction for unit-holders. Proposed regulatory changes to broaden loan distribution for Canadian mutual funds through deeper collateral optimisation will help managers further reduce their costs. As a member firm of the Canadian Securities Lending Association (CASLA), RBC Investor & Treasury Services (RBC I&TS) fully supports industry efforts to move forward with this important regulatory change.

Tomada: CASLA continues to work with the regulators on this initiative. It supports positive change for industry stakeholders, including the ability for Canadian mutual fund managers to expand their acceptable collateral profiles to include equities for securities lending transactions. CASLA continues to support positive change for industry stakeholders and the association looks to align and strengthen its presence with regulators across Canada and other global associations.

Pries: CASLA's efforts for the industry continues with reforms on NI81-

102. Northern Trust has representation on CASLA's executive committee and is an advocate for our clients through this industry group.

Besides weathering the disruption to business and market volatility, what else is on the agenda for Canada's market in 2020 and beyond?

Pries: Demand has waned somewhat within the general collateral (low-demand securities) space due to the greater focus on high-demand securities (specials). While specials continue to be very name-specific, the Canadian specials market benefitted from continued directional trading in the speciality pharmaceutical sector. Continued volatility in global commodity prices is also expected, furthering directional short interest across the oil and mining sectors. Also, with the retail industry facing headwinds from large scale unemployment, widespread shutdowns and weakened consumer spending demand for names across the sector will increase as many retailers will struggle to avoid closure amid plunging sales and earnings.

One trend that continues over the past year is the increased demand for fixed income securities, specifically HQLA assets, alongside growth in term structures as borrowers pursue additional means to utilise their balance sheets more effectively. There has always been a preference for non-cash collateral in Canada and our expectation is that non-cash collateral balances will continue to grow going forward. Borrowers continue to seek out opportunities to pledge a wider array of non-cash collateral including equities, corporate and convertible bonds as they look to manage their long portfolios with greater efficiency.

Beneficial owners can put themselves in a position to take advantage of this preference by reviewing their collateral guidelines and ensuring they are aligned with the trend toward non-cash collateral, accepting a wider range of collateral that fits within their risk appetite and that they permit entry into term trade structures.

Conroy: One of the challenges we anticipate is how do we adjust the economy for structurally lower-for-longer rates and lower-for-longer commodity prices. The economic disruption is ongoing and will be a major consideration for lower-for-longer impacts. We could possibly see a more domestic approach to goods and services that will impact international import supply chains. We could see a consistent reduction in Canada's energy and materials exports.

Kolasingh: Prior to COVID-19, two key themes within the Canadian securities lending market were environmental, social and governance (ESG) factors, and regulatory change. ESG was propelled to the forefront when one of the world's largest pension funds cited the fundamentals of ESG —particularly proxy voting and transparency — as its rationale for withdrawing from lending. Proxy events and governance have, however, co-existed within the securities lending paradigm for many years. At RBC I&TS, we work closely with our lending clients to understand their investment policies and governance requirements, including ESG factors, striking the optimal balance with a tailored securities lending programme. This requires timely dissemination of publicly available information, an area that admittedly requires further discussion and improvement across the industry.

In addition, several regulatory changes impacting global securities lending markets, including Canada, are planned to take effect in 2020.

Alexa Lemstra
Head of EquiLend Canada

The four top cannabis stocks made up 42 percent of the annual lending revenue generated in Canada in 2019. So far in 2020 the same four names have made up 44 percent of revenue

Katie Pries
President and CEO
Northern Trust Canada

One trend that continues over the past year is the increased demand for HQLA, alongside growth in term structures

The Securities Financing Transactions Regulation (SFTR), a body of European legislation designed to enhance the transparency of SFTs, including securities lending and repos, is top-of-mind with multiple implementation phases. The first phase was originally scheduled for implementation in April 2020 but, due to COVID-19, has been pushed to July 2020.

The delay was generally welcomed by the securities finance community as stakeholders were focused on implementing business continuity practices related to COVID-19 during April. While RBC I&TS was ready to implement SFTR, the additional time has enabled further testing with our vendors and counterparties. We also continue to prepare for the Central Securities Depositories Regulation (CSDR) and Shareholders Rights Directive (SRD) II, both of which have near-term implementation timelines. From a settlement perspective, CSDR has the potential to be beneficial for the lending industry, particularly over the long term, as the market becomes more efficient through enhanced processes and technology to manage the transaction lifecycle. We could also see an uptick in demand as increasing numbers of financial institutions borrow more securities to avoid penalties included as part of CSDR's Settlement Discipline Regime. As for SRD II, we have established an internal project team that continues to engage with various industry bodies, while further progressing our implementation plan.

Tomada: As Canada and the rest of the world work through and recover from this pandemic and its economic impact, we expect to see continued demand in the sectors most impacted by this economic slowdown – energy, materials, travel, airlines, retail and potentially the financial sector. We anticipate a sustained interest in the borrowing of HQLA as firms continue to source and potentially shore up liquidity needs. As borrower demand has been changing rapidly and evolving in this unprecedented environment, we will continue to discuss with our clients the impact of collateral flexibility on their securities lending programme. We also expect a continued focus on technology innovation and automation across industry participants.

Lemstra: As our clients emerge from the market throws of March and April, they appear to be back on track to business-as-usual, albeit still in a work-from-home mode in most cases. Systems operated well during the market volatility, however, strong themes of efficiency and automation continue to be as much of a priority as they were pre-COVID, if not more so now. Collateral management, trading and post-trade efficiency are all key areas for adding scalability and efficiency to day-to-day business operations, particularly in volatile markets. The rest of 2020 entails creative ways to communicate and engage with clients, colleagues and counterparts as we figure out this new norm as an industry.

Stocks related to the cannabis sector have been the big earners for lenders for a long time now. Do you foresee that trend being overturned soon, given the current situation?

Lemstra: The four top cannabis stocks made up 42 percent of the annual lending revenue generated in Canada in 2019, and so far in 2020 the same four names have made up 44 percent of total revenue. However, fees in the broader pharmaceutical sector have been declining since mid-February through the end of April.

Conroy: The Cannabis industry has been a major driver of securities lending revenue in Canada over the past few years. Rebalancing due

to index deletions is expected to disrupt supply. Cannabis stock market values have dropped by 60 percent to 90 percent from their 2018 highs, which has led to a reduction in the overall notional on loan. This has resulted in a reduction in revenue despite lending rates remaining elevated. We are likely to see the lending levels remain special for as long as a material portion of the market is restricted from owning or lending these securities.

Pries: Directional short demand is still highly prevalent in this sector with no expectations of decline given it remains heavily indebted with ongoing supply issues, regulatory challenges and potential mergers and acquisitions activity expected as the industry continues to mature. The feeling that the speciality pharmaceutical sector remains greatly overpriced was reinforced after the much-anticipated roll-out of edibles and drinkables in late January which failed to live up to the lofty expectations of certain analysts. March also saw an increase in short interest, borrower demand and in companies burdened by high debt levels and poor cash flow as dispensaries were forced to close to help reduce the spread of the coronavirus. Prior to the pandemic, with the expectation of a considerable drop in pricing and margins, companies in this sector issued revenue warnings for the fiscal 2020 outlook. The effects of the pandemic have only increased the likelihood the anticipated revenue downturn will be realised.

Tomada: The cannabis sector continues to be a leading securities lending revenue generator, but the revenue for Canadian equities is now more widely distributed across various asset classes. With the market correction that occurred in March, there was downward pressure on rates for selected securities within the cannabis space, thus reducing revenues from previous highs. With recent events, we may see increased consolidation in this sector.

Kolasingh: Following legalisation of cannabis in Canada more than 18 months ago, the cannabis sector continues to show strength in the lending market. Since the end of 2018, cannabis has consistently topped specials (excluding corporate event-driven names) amidst a somewhat depressed environment for warm and hot securities.

However, lending levels remain volatile, largely a reflection of underlying securities prices but also due to the dynamic macro-economic climate and a constant stream of news coverage generated by the sector, including various players' financial results.

While lending levels were up in March, overall revenue attributed to the sector declined due to sharp price depreciation. Nevertheless, the cannabis industry is currently a significant source of incremental value in the Canadian lending market and we anticipate this trend to remain throughout 2020.

According to RBC, Canadian pension funds recorded healthy returns in 2019. How is 2020 shaping up by comparison? What are the key drivers that will affect their revenue?

Kolasingh: Canadian pension plans continue to perform well in the securities lending market despite the ongoing decline of primary revenue drivers such as specials. This may be due to the large quantity of HQLA held by pensions as part of their long-term investment horizon, which is conducive to duration-structured term loans. Amidst the market volatility

Nick Conroy
Director, head of Canadian securities lending
Scotiabank

One of the challenges we anticipate is how do we adjust the economy for structurally lower-for-longer rates and lower-for-longer commodity prices

of the first quarter of 2020, HQLA stood out as an increasingly in-demand asset class, enabling us to capture this heightened demand and further optimise beneficial owner portfolios. As investment strategies continue to evolve in this space, Canadian pension plans stand to further optimise their portfolios through dynamic securities financing relationships with their agent lenders.

At RBC I&TS, we continue to work with beneficial owners to tailor solutions that, depending on their particular needs, combine agency borrowing and self-borrowing within an overall securities lending mandate. This can help support greater revenue optimisation through the delegation of collateral management and reduced borrowing costs while creating efficiencies for pension plans and their investment managers.

Lemstra: Canadian pension plans are down 8 percent in average fee and 13 percent in utilisation Q1 2020 over Q1 2019. This decrease is a trend across the global beneficial owner community, which also saw a drop in fees and utilisation of 16 percent and 10 percent, respectively.

Pries: Having a strong presence in Canada and being close to the market, Northern Trust supports the growth and performance aspirations of the Canadian pension market. It is our view that securities lending will likely continue to be a positive contributor to pension fund returns in 2020.

A couple areas that beneficial owners will want to keep an eye on are: collateral expansion, term structures and emerging markets. While we have discussed collateral and term previously, emerging markets continue to be an important source of securities lending revenue for beneficial owners. Northern Trust, through our global network of borrowers and trading desks provides the market expertise and access to securities lending in both the developed and emerging markets.

Tomada: The Q4 2019 median return of the BNY Mellon Canadian Master Trust Universe – a BNY Mellon Global Risk Solutions fund-level tracking service that provides peer comparisons of plan sponsors' median returns – was +2.52 percent for the fourth quarter of 2019 and the one-year median return as of 31 December 2019 was +13.92 percent. As CIBC Mellon reported in its 3 February 2020 press release on the Q4 2019 universe results, Canadian plan sponsors continued to post positive median returns last year amid easing economic uncertainty.

In contrast, for the first three months of 2020 – as CIBC Mellon reported in its 4 May press release on the Q1 2020 results of the BNY Mellon Canadian Master Trust Universe – significant market losses were experienced as well as a worldwide economic decline, and all equity segment returns displayed negative results across the board due to the global pandemic and market volatility. The median return of the BNY Mellon Canadian Master Trust Universe was -7.23 percent for the first quarter of 2020 and the one-year median return as of 31 March was -1.13 percent. Canadian foundations and endowments posted the lowest performance among plans for the first quarter of 2020, with a median performance of -10.70 percent. The BNY Mellon Canadian Master Trust Universe outperformed the median returns of Canadian pension plans over $1 billion by 39bps for Q1 2020.

While we have seen markets rebound from the significantly negative returns, investors must continue to deal with increased market volatility, and overall market confidence, to fully rebound from the Q1 negative returns.

CASLA's annual conference was one of the many industry events that fell victim to the global lockdowns. What were the highlights of the event meant to be, for those industry participants who do not focus on the Canadian market year-round?

Conroy: It is easy to imagine the next CASLA discussing the material changes in the market due to COVID-19. Technology has played a huge role in overcoming the challenges of working from home. The actions by the Bank of Canada and the second and third-order effects of such policies have put a defining stamp on the year to date.

This year's conference would have been the 10th anniversary of CASLA. There were plans to have a Canadian twist on a wide range of things: buy-side client panel, ESG discussion and the effects on securities lending, liquid alts, fully-paid lending and regulatory challenges. The board did a fantastic job planning and securing guest speakers.

Tomada: The CASLA conference has become an important gathering for securities lending participants. This year would have seen several topics including an update on the Canadian cannabis sector, a session on women in capital markets, an economic update from CIBC World Markets, and a panel session discussing ESG in the Canadian market. The topic of ESG was to be a focus area at the event as ESG investing continues to gather momentum globally.

Leaving the dock and setting sail

Justin Lawson reports

Broadridge's Darren Crowther talks to SLT's Justin Lawson about his new role as general manager and the implications of SFTR and CSDR during the COVID-19 pandemic

Congratulations on your new role. How are you adjusting?

I took over mid-January with a transition period in place with Jerry Friedhoff who has decided to retire, so I'm several months into the role now and things have been going well. Obviously, it's been pretty challenging taking over during this terrible period of the COVID-19 pandemic, given what it means to our own business and client's business. At the same time, our Securities Financing Transactions Regulation (SFTR) projects have been coming to an end. It's been good fun, lots of good interaction with the clients and the staff.

With Jerry seeming to retire at just the right time, what words of wisdom did he leave you with?

Jerry's words of wisdom are probably the same words we have been communicating to our management team for a while, which is that client service is the key to success. So, keep living this story, keep doing the things to make the clients happy, to make the client want to continue to use our services, ensuring the client wants to grow with us as a business. Coming from a client service background, I'm very keen on those principles that we focus on the client's happiness levels, and we really try to make the best of the relationship.

What is the main focus for Broadbridge's securities finance and collateral management business for the next 12 months?

Probably three months ago I would have given you a different story. But, our focus has changed because of COVID. Whereas before we were a natural growing business, we were bringing on new clients, new products, etc. The impact of COVID is terrible in what it's done to society, causing problems and pain. For our clients we are just trying to help them through it, Broadridge and the securities finance division had a very strong business continuity plan (BCP) in place, we were able to move to that along quite quickly.

So now, our three-month focus is helping the clients through the challenges they have, then I would say the next three months will be moving back towards business as usual i.e: SFTR second wave, the Central Securities Depositories Regulation (CSDR) product build-out and working with clients on how we can help them with the next stage of their BCP process. Undoubtedly, there will be things that need to change, in regards to their operations and applications, and technology in the coming months.

After that, I would probably say, moving forward with supporting clients, building great products, interacting with all the other market utilities to make it as straight-through-processing-friendly and seamless as possible from the trade execution all the way through.

How are your clients dealing with the current crisis?

There were a lot of challenges in the first few weeks but then things are now better. I think for everyone it was a big shock to move to home working, which has definitely been the biggest challenge that all the organisations have faced. It's not specific application problems, it's more infrastructure, networking and facilitating the staff, and specifically the trading staff to be able to work from home and being able to work in the same way they were before. Broadridge has a global footprint and we moved to BCP in Asia much earlier, and we learnt lessons from that on how to do that well for the clients. Those lessons have been passed on as we moved around the globe, through Europe and the US. Our BCP and the clients' BCPs that we have worked with have been pretty good.

Is regulation still a core focus for your group at the moment?

SFTR has been the core focus mainly because of the major impact

it has had. There have been a lot of connectivity point changes, and we have had to work closely with a lot of other organisations and vendors, which has been great because it has bought the utility space together. We can talk more and discuss how better interactions can be done.

Moving forward with CSDR, regulatory changes will happen, but it's more of an operational change. Partial settlement is going to see a big change for the marketplace and how that impacts things and how the settlement cycle works.

What lessons have you learned so far from testing your SFTR solution with clients?

A key lesson is to get started early. For example, we have discussions with the International Securities Lending Association very early on about how it's all going to work. We also made an effort to contribute to forums and groups like many of our clients were. Making a decision on the way forward early on how we are going to do it, how things are going to be implemented and how things are going to look.

Lessons that have not been learnt from previous regulatory changes have led to a misunderstanding and a disagreement around what the actual requirements are. So, we have had to be quite flexible in the way we have built the solution and we knew that not everybody was going to agree with how it would be reported at the beginning, so we have had to maintain flexibility. Unfortunately, the lesson of getting it nailed down from the start hasn't exactly been heard on that side, so we are being flexible and working with our clients to get them ready for production.

The delay hasn't caused us a problem. It's allowed us the opportunity to review with the clients on what we have done in more detail and make sure it's going to work for the business, so it's given us that opportunity to make it even better than it was before.

With the upcoming CSDR regulatory changes coming up in the next 12 months, what advice would you give your clients?

I would probably say similar to the story that we talked about with clients around SFTR, think about it now and look at your operational process and how it's going to have to change. Work with Broadbridge if you are our client, if not work with your utilities and vendors to make sure you understand the implications of CSDR because it's going to be wide reaching. There are going to be a lot of changes that will be required for the operating model and systems to meet CSDR's requirements. You need to be ready so get the work done upfront and get an understanding of the level of detail you need.

Click here to watch the interview online

The delay hasn't caused us a problem, it's allowed us the opportunity to review with the clients on what we have done in more detail and make sure it's going to work for the business

Darren Crowther, general manager, Broadridge

Juice worth the squeeze?

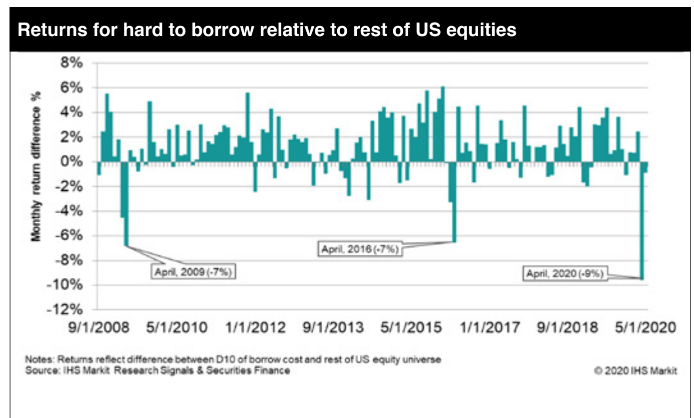
Samuel Pierson
Director, securities finance
IHS Markit

IHS Markit's Sam Pierson reviews the historic US equity short squeeze in April

April came in like a lion and tore the bear to shreds. Over the four weeks of April, highly shorted US equities outperformed those with lower short interest by the most on record for any month. That statement holds for a variety of measures of short interest (borrow cost, utilisation of lendable shares, borrowed shares as a percent of outstanding, exchange SI percent outstanding). It is also true for a US equity total market capitalisation universe, as well as large and small cap in isolation.

Other contenders for 'worst month for shorts' (see figure 1) include April 2009 and April 2016. The most hard-to-borrow (HTB) US equities outperformed the average returns for the rest of US equities by 9% in April, a harsh snapback after HTB only managed to underperform by 2 percent in the March crash.

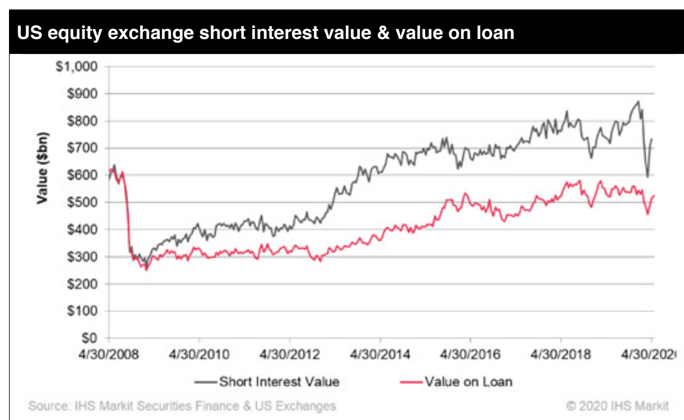
Figure 1 *Source: IHS Markit Securities Finance*



As noted in our Q1 webinar, the US equity short interest in dollar terms fell with the market in the first quarter, with the short interest observation for 31 March ($595 million) the lowest level since 2014. The decline in short interest reported by the exchanges was double the decline in US equity value on-loan reported by IHS Markit Securities Finance. That gap is justified by a reduction in internalisation by dealers and increased borrowing for exchange-traded funds creation. The reduction in internalisation was interpreted as likely being related to hedge fund deleveraging.

Seeing the short interest value decline by roughly the same amount as the broader market suggests that there wasn't any significant increase in short selling during the crash.

Figure 2 *Source: IHS Markit Securities Finance*



In the May 2020 Financial Stability report the Federal Reserve Board noted that although dealers had reported, in the March Senior Credit Officer Opinion Survey on Dealer Financing Terms, "that the use of leverage by hedge fund clients was about unchanged in the fourth quarter of 2019 and the first quarter of 2020", that subsequently "hedge funds reportedly reduced their leverage significantly as market volatility rose and many hedge funds experienced margin calls".

A reduction in hedge fund leverage reduces the supply of shares that dealers can source internally to settle short positions; Short interest increased by 23 percent in April, while the value on-loan only increased by 13 percent, which may reflect hedge funds starting to increase gross exposures again (which in turn increases internal supply and reduces the need to borrow externally to settle a short sale).

Conclusion:

Being long a stock with significant short interest whose price increases on a parabolic trajectory seems like a good time, particularly coming out of a market crash. Following that experience, one might reasonably look for other such opportunities, which may be the current collective mindset of short-term traders, be they institutional or retail. Over the past six weeks, the market has rewarded betting that crowded shorts will outperform. Instances of HTB outperformance have generally been brief, however, there have been two prior three-month-long periods of outperformance since 2008, so while the scale of April is extreme the duration of this HTB rally is not (yet).

The prior two times HTB equities outperformed by as much as they did in April, the preceding month also featured outperformance and was followed by at least two months of the typical underperformance of HTB (gross of fees); Through the first three weeks of May, HTB equities have continued to outperform by 0.8 percent.

Two sectors which have seen increased share borrowing in May include airlines and cruise lines, which have been particularly hard hit by the COVID-19 related shutdown. Seeing increased short demand in those sectors, after the April rally, suggests that at least some investors still believe that the economic recovery timeline may take longer than the market's.

Samuel Pierson
Director, securities finance
IHS Markit

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Comings and goings at Trading Apps, UBS, CBA and more

UBS, the London-based financial services organisation, has appointed Sachin Gupta as its director for securities lending in Japan.

Gupta joins from Deutsche Bank where he served in several roles, including his most recent position as vice president for nearly seven years based in Japan.

Prior to that, he served as an analyst within global prime finance for two years in Mumbai, India.

Before that, Gupta served as a junior analyst for a short stint at JM Financial Consultants.

UBS has declined to comment on any additional details.

The Commonwealth Bank of Australia (CBA) is bolstering its international securities finance teams as part of plans to grow its business globally.

The bank recently made an appointment to its European team shortly after building out its Americas office.

Earlier this month, the bank welcomed Naomi Kirwan from ING who has been brought on to focus on CBA's securities financing activities in Europe.

More broadly, a spokesman for CBA says Kirwan's role will consist of supporting both new and existing clients in the global securities finance (GSF) space.

Based in London, she reports to Russell Simpson, CBA's global head of GSF.

Prior to CBA, Kirwan was a director in GSF at ING for more than four years.

Before that, she served as a vice president at Bank of America Merrill Lynch.

The appointment comes shortly after CBA moved Shelby Kaye internally from the treasury to its GSF team in New York in order to expand the business in the Americas.

The spokesperson tells SLT that the hires are part of a global strategy to grow the GSF business at CBA internationally.

Comyno, a fintech software and business consultancy boutique, has appointed Frank Becker to the newly-created role of COO and head of sales.

Based in Frankfurt, Becker's new role will focus on growing the sales and marketing team and expanding the customer groups and partnerships with other industry participants.

Before Becker's promotion, he had been with Comyno as head of business development for almost four years. Overall, Becker has more than 15 years of industry experience in the financial market in various related roles, from trading to consulting.

Commenting on the hiring, CEO Markus Büttner, says: "Frank has a unique set of skills rooting in many years of professional experience and exceptional performance.

"By connecting and motivating all people involved, on both business and personal level, his contribution to our customers' satisfaction cannot be exaggerated. We are very proud to have him on our board".

Comyno says its securities finance and collateral management platform has been "heavily enhanced" as the firm grows adding that "it is now the first of its kind to handle classic and digital assets by linking up to legacy settlement structures as well as blockchain and distributed ledger networks".

Trading Apps has completed an internal acquisition process as of Q1, thereby putting an end to speculation of an external sale.

The leadership team of Laura Allen as managing director, Stefan Bates as chief technology officer (CTO) and Matthew Phillips as head of delivery, have been joined by two new directors Ciaran O'Donnell (CFO) and Den Leonard, a newcomer to the sector who has taken up a position as executive chairman.

Leonard sold his business to a private equity investor 12 months ago and has been appointed to support the Trading Apps management team with the next chapter of the company's progression.

Meanwhile, Carol Kemm has been enticed out of retirement to join the firm as a consultant director to bring her considerable experience as a key figure at FIS Global One for 18 years, to bear on Trading Apps plans for expansion.

Kemm tells SLT that she is eager to apply her knowledge of middle and back-office functions in securities lending businesses from her time with Global One as well as her relationships with its customers.

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To this end, Kemm says she is able to "act as a bridge" between those areas and Trading Apps' well-developed front-end expertise.

Allen adds: "The engagement of Carol Kemm is a pivotal moment for Trading Apps. Carol brings a wealth of experience and a broad network which will strengthen our product and reach."

Following the sale of its agency securities finance business to BNY Mellon in December 2018, Trading Apps has focused on broadening its functionality and evolving its technical architecture.

The appointment of Kemm comes as part of this repositioning and Allen tells SLT that the firm has been working hard in the past year to create new functionality to improve clients' operations and connectivity.

There is a renewed sense of excitement within Trading Apps, having gained fresh investment, the firm says it will continue developing leading-edge software to provide bespoke solutions that set it apart from other vendors with "out-of-the-box" solutions.

Trading Apps is expected to make a series of further imminent announcements regarding key appointments and also technical developments that will make their solutions more accessible and attractive to any securities finance participant.

INTL FCStone Financial Services has appointed Brendan Nicholson as assistant vice president (AVP) for its prime brokerage operations.

INTL FCStone is a financial-services firm that provides trading, exchange, and over-the-counter execution and clearing services for commodities.

Nicholson reports to managing directors and co-heads of prime brokerage, Nicholas DeJarnette and Douglas Nelson.

Based in Atlanta, Nicholson joins from Citi where he spent over five years in several roles, including most recently as AVP and multi-asset group team coordinator for a short stint in September 2018.

His previous positions include multi-asset group intermediate transaction capturer and middle office analyst.

Nicholson comments: "I am looking forward to providing unparalleled access and customer service to help clients meet their objectives across a wide array of markets."

Raiffeisen Gruppe expand executive board

Raiffeisen Gruppe has appointed Roger Reist as the newest member of its executive board.

As of May, Reist has taken on the role of head of treasury and markets for the Swiss bank.

Reist, who is based in Zurich, joins from Zurcher Kantonalbank where he had served since 2010. Most recently, he served as head FX and precious metals for a short stint in 2020, having spent the prior nine years as head of securities lending and repo.

Before that, he served at UBS Investment Bank for five years, first as a securities lending and repo trader and then as a trader focused on FX forwards, interest rate swaps, forward rate agreements, and money markets.