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The primary source of global securities finance news and analysis
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Against the clock

Cappitech's Ronen Kertis discusses why the closure of CME's regulatory reporting service could cause the cost of reporting to rise and how it might make firms rethink what they look for in a provider

SFTR Diaries

Market participants offer a peek behind the curtain of what the period during last months go-live was really like

Panel Discussion

ISLA's SRD II working group unpack what the incoming update to the Shareholders Rights Directive means for securities lending

Data Analysis

Short sellers are betting on Kodak's decline (again). IHS Markit's Sam Pierson surveys the situation

Clear Street secures several key hires for securities finance growth

Clear Street has snapped-up several industry heavyweights including Robert Chiuch, James McDonald and Mark Skowron to form a new securities finance initiative, while also welcoming Vincent Avena to lead its securities lending and prime funding offerings.

The agency lending veterans have been free agents since 2019 but have now been brought together to create a new team aimed at improving the securities finance experience for Clear Street's institutional clients.

The trio previously led global securities finance businesses at BNY Mellon, State Street and Northern Trust, respectively, and, combined, led activities for equity and fixed income securities finance programmes with assets under management in excess of $9 trillion, spanning 30 global markets.

Chiuch left his role as BNY Mellon's global head of equity and fixed income finance in January 2019, after almost eight years with the US bank, while McDonald parted ways with State Street along with several other senior executives a month later.

Based in Boston, McDonald served in a variety of roles since 1994, including his most recent as head of global securities lending.

Meanwhile, Skowron left his role as Northern Trust's head of US securities lending trading in June 2019. He joined the bank in 2000 as head of US equity securities lending trading, before assuming his latest role in 2009.

They have now formed a new division called CS Financing Solutions, which will focus on helping institutional investors, intermediaries, and other stakeholders increase the profitability of their securities financing programmes.

A spokesperson for Clear Street says the new team will also explore new opportunities to serve a much broader range of institutional clients, such as public, private-public and private pension funds, mutual funds, and endowments.

The division will report directly to Clear Street CEO and co-founder, Chris Pento, who outlines his ambitions for it to "take an agile, boutique-style approach to client service, using any combination of financing, liquidity, and collateral management structures to deliver optimal results for clients".

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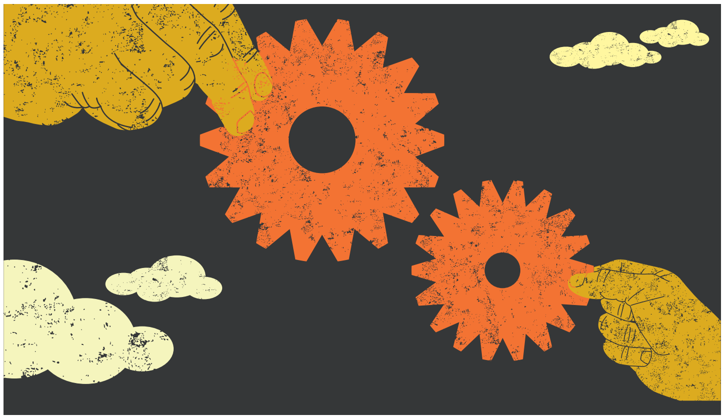

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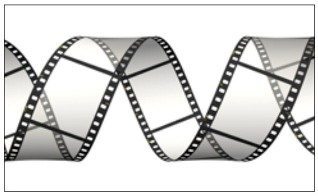

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Clear Street secures several key hires for securities finance growth

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Clear Street has further added to its roster with the appointment of Avena from TD Securities.

Avena was chosen, according to Pento, for his more than 40 years of experience leading multibillion-dollar securities lending programmes at institutions including BNP, Bank of America, Albert Fried, and Montgomery Securities.

"Vincent will work alongside our client support, execution, financing, and engineering teams to further modernise the securities financing experience for clients — improving efficiency, increasing price transparency, introducing new products, and expanding service options," says Pento.

All four began their new roles earlier this month.

Clear Street now boasts a 12-strong securities lending team, having first formed the desk just over a year ago with the hires of Jack Nicosia, Salvatore Cangialosi and Charles Ross, who were joint leaders before Avena's appointment, along with Antonio Maneri.

The spokesperson adds that, under Avena, the securities lending team aims to serve Clear Street's growing list of customers, ranging from emerging funds to established institutions, as well as set out plans for further expansion to the team and product range.

Hong Kong broker Futu continues "exponential growth"

Futu, an online broker for Hong Kong and mainland China, has reported an 83 percent year-over-year increase in Q2 balances for its margin financing and securities lending balances.

Balances for these businesses now sit at HK$7.5 billion (USD 967.7 million) as of the end of June.

Leaf Hua Li, Futu's chairman and CEO, explains that the growth also led to a bumper quarter for interest income, which hit HK$207.9 million (USD 26.8 million), an increase of 82.5 percent from HK$ 113.9 million (USD 709.6 million) earned in the second quarter of 2019.

"We generated higher interest income from initial public offering (IPO) financing due to an active Hong Kong IPO market, higher bank interest income due to higher idle cash balance from clients as well as higher margin financing interest income due to the increase in daily average margin financing balances," he says.

The Hong Kong IPOs of JD.com and NetEase alone garnered Futu north of HK$15 billion (USD 1.94 billion), the broker says.

"We believe that the increase in US-listed Chinese companies seeking a secondary listing in Hong Kong and the surge of high-profile Hong Kong IPOs will act as major tailwinds to our growth," Hua Li adds.

Overall, Futu's investing platform, Futubull, which provides market data, trading service and news feed of Hong Kong, Mainland China and US stock markets, saw strong growth across all metrics.

By the end of Q2, total trading volume increased 202 percent year-over-year to reach “historic highs” of HK$643.9 billion (USD 83 billion), according to Futu’s CEO.

Of this total, trading volume for US stocks was HK$429.3 billion (USD 55.4 billion), trading volume for Hong Kong stocks was HK$209 billion (USD 26.97 billion), and the trading volume for stocks under the Stock Connect was HK$5.5 billion (USD 709.6 million).

Meanwhile, Futu reported that the total number of users increased 52 percent year-over-year to 9.3 million, with the growth rate of paying clients from the mainland hitting a “record high” since Q4 2018, while the growth of Hong Kong-based paying clients further accelerated to 125.2 percent year-over-year for the quarter.

“During our full-year 2019 earnings call, we guided for 90,000 paying clients addition in 2020,” Hua Li notes. “Six months into 2020, we have already exceeded our full-year growth target.

Futu is now projecting to attract 280,000 net new paying clients this year, which would represent a 141 percent year-over-year growth in its total number of paying clients. Unsurprisingly, the across-the-board growth led to the broker’s total revenues increasing 164.4 percent year-over-year for Q2, to sit at HK$687.6 million (USD 88.7 million).

Futu also used its Q2 report to reveal it has established partnerships with “eight reputable mutual fund managers”, including T. Rowe Price, Franklin Templeton and Amundi.

Moreover, as of August 12, Futu Singapore was granted in-principle approval from the Monetary Authority of Singapore for the Capital Markets Services licence application.

Hua Li says: “This marks a milestone of our internationalisation, and we will continue to look for new markets to extend the footprint of our business.”

Margin Reform partners with SteelEye

SteelEye, the compliance technology and data analytics firm, has partnered with Margin Reform to support the consultancy’s clients with compliance and regulatory reporting solutions.

Margin Reform will provide SteelEye’s RegTech suite to its financial clients as they address the challenges of the evolving regulatory landscape.

During lockdown, many firms have faced increased complexity around regulatory compliance with regulations like the second Markets in Financial Instruments Directive (MiFID II) and the European Market Infrastructure Regulation (EMIR), the partners explain.

Major players such as CME and Deutsche Boerse announced that they are leaving the regulatory reporting market, requiring thousands of firms to find a new solution.

At the same time, the UK’s Financial Conduct Authority (FCA) has increased its scrutiny on reporting accuracy and market abuse oversight, while surveillance is becoming harder with more people working remotely.

Matt Smith, CEO at SteelEye, highlights: “There has been a significant increase in the demand from affected clients seeking automated solutions to properly handle their regulatory reporting and other compliance requirements.

"It is a situation that is ideally suited for SteelEye's regulatory reporting and wider compliance suite, designed to enable firms to seamlessly manage multiple regulatory requirements within one platform."

A spokesperson for the firms tells SLT that client demand has driven this partnership, with Margin Reform having recorded "an exponential increase in enquiries around regulatory compliance and reporting solutions".

Consequently, the consultancy selected SteelEye "because of its broad range of RegTech solutions offered and data-centric approach to compliance".

SteelEye's reporting suite captures and validates client data in real-time and automates large parts of the MiFIR/EMIR transaction reporting process.

By doing so, SteelEye aims to address the significant data integrity challenge many firms have faced following recent regulations and enables them to improve their operational efficiency while freeing up resources.

"Over the past two months, we have experienced a significant increase in the number of enquiries from clients around regulatory reporting," says Shaun Murray, CEO of Margin Reform.

"To support our growing client base, we wanted to partner with a vendor offering a highly-automated and efficient reporting solution as part of a wider compliance suite. After a careful review of the market, the breadth and scope of the SteelEye offering stood head and shoulders above the competition."

Broadridge reports favourable 2020 fiscal year figures

Broadridge Financial Solutions has reported total revenues of $4.5 billion in the fiscal year ended 30 June 2020, marking an increase of 4 percent compared to the same period last year.

The corporate services firm totalled recurring fee revenues of $3 billion, an increase of 10 percent from $2.7 billion in 2019. This growth was attributed to high organic internal growth, including acquisitions, global technology and operations, which were driven by higher trading volumes from market volatility.

It was also noted that internal growth in Broadridge's investor communications segment, driven by strong stock record growth and a shift of proxy communications into Q4 by the COVID-19 pandemic, was responsible for higher recurring fee revenues.

However, operating income fell by 4 percent to $625 million, attributable to charges associated with the information technology agreement with international business machines for private cloud services.

Tim Gokey, CEO of Broadridge, comments: "With an exceptional fourth quarter, Broadridge reported the strong fiscal year 2020 results. Our full-year performance, despite event-driven headwinds and the ongoing COVID-19 pandemic, further validates the Broadridge business model and value proposition."

"I am especially pleased to report that we have achieved our three-year objectives for recurring revenue growth, margin expansion, and adjusted earnings per share growth. Our progress against these goals is a strong indication that our strategic focus on industry solutions for governance, capital markets, and wealth management is on-track," Gokey continues.

"Despite macroeconomic uncertainty, our outlook for the 2021 fiscal year calls for continued organic growth, anchored by a record revenue backlog, and balances cost discipline and increased investment that will position us to take advantage of the recovery and drive long-term growth," Gokey concludes.

Seb Malik
Head of financial law
Market FinReg

MiFID II roundup

There have been a number of updates to the second Market in Financial Instruments Directive (MiFID II) this week that the industry should be aware of. Principle among these is the joint consultation by the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) on issuing updated guidance on suitability requirements for management boards and "key function holders".

Members of the management body should have sufficient time to carry out their respective responsibilities appropriately. Members of the management body should have sufficient time to cover all the necessary subjects in-depth, and in particular the management of the main risks. They should also "have sufficient time to acquire, maintain and enhance their knowledge and skills – if necessary through additional training". They will be required to maintain up-to-date knowledge at all times. This knowledge must be individual for the particular role, and collectively for the management body to fulfil its responsibility.

The agencies are keen that individuals in management bodies demonstrate "independence of mind".

We at Market FinReg have regularly touted the necessity of training right across the full ambit of legislation and not just transaction reporting for operations staff. We agree with the authorities' intended requirement that institutions need to provide "sufficient resources for induction and training of members of the management body…[and] ongoing training". It is unfortunate that too many firms consider training in key legislation and regulation as an unnecessary expense rather than an essential consequence of sitting on the management body.

The authorities request a diversity of skills to prevent "group think" as well as gender-diversity yet it is with profound regret that ESMA and the EBA jointly failed entirely to make reference to racial diversity.

Such a glaring omission comes at a time where corporations are rushing to identify with Black Lives Matter. The EBA and ESMA are left open to the charge of being tone-deaf to a scourge that is rapidly assuming centre-stage in the world's conscience. Last year, Trevor Phillips, the founding chair of the UK's Equality and Human Rights Commission expressed considerable frustration: "Our latest analysis shows that after five years of monitoring, the promise that things would change over time for ethnic minority leaders in the FTSE 100 looks just as empty as the corporate pipeline. Women are cracking the glass ceiling, but people of colour remain super-glued to the corporate floor." It is, perhaps, due to the lack of seriousness at the highest levels that little progress has been made. ESMA and the EBA could set an example of best practice by engaging in an audit of their own institutions for gender and racial diversity.

In other news, MiFID II's pre-trade transparency regime will come under renewed pressure as ESMA revealed there are only 569 liquid bonds in the EU. Related, only 56 instruments breached the double volume cap (DVC) that under certain conditions exempts trading from transparency requirements.

This is encouraging news as, prima facie, it suggests the DVC is calibrated at about the correct level.

Regarding Systematic Internalisers (SI) (firms that deal on their own account when executing client orders) "upon request of market participants, [ESMA] decided to compute, the total volume and number of transactions executed in the EU in order to help market participants in the performance of the SI test". This is welcome and will help firms calculate for which instruments, if any, they are SIs.

Returning to the management body consultation, my principal concern is the lack of enforceability of existing, and future proposals. I note that during MIFID II's passage through the legislative process, the European Parliament added the below provision that provided a route to civil liability (the ability for a person to sue a company for failures):

"without prejudice to the legal systems of the member states, they should ensure that where it is alleged that a member of the management board of an investment firm or of a market operator has breached the provisions of or has committed an offence in matters falling within the scope of this Directive or…[MiFIR], he may be personally subject to criminal or civil proceedings."

This provision never made it to the final text in a process that is not entirely clear. For an academic paper I am authoring, I have submitted Freedom of Information requests to clarify.

As I have written in previous memos, legislation that has no effective remedy is of questionable value.

SFTR Diaries

Drew Nicol & Natalie Turner report

Market participants offer a peek behind the curtain of what the period during last months go-live was really like

Given the year we've all endured so far, there are many reasons why you, dear reader, might be reading this rather than relaxing at your preferred foreign holiday destination, but the Securities Financing Transactions Regulation (SFTR) probably isn't one of them.

After years of hand-wringing, heated discussions at industry events and conference rooms, to say nothing of the untold hours of toil by IT development teams, SFTR's launch day came and went without much fanfare – and not just because most people were at home. Nonetheless, it is here. Phase one and two of SFTR, which affects investment firms, credit institutions, central counterparties and central securities depositories, has initiated the largest data-collection exercise the industry has ever known. The International Capital Market Association (ICMA) has published a weekly SFTR data snapshot since go-live, which, a month on, has revealed that the number and total value of transactions have remained steady thus far.

Per week, roughly 1.5 million SFTst are being reported to trade repositories with a cash value of between €14 trillion and €16.5 million. Every week repo accounted for at least 90 percent of the total value of reported transactions, while securities lending trades made up roughly two-thirds of the total number of transactions.

Reports from those at the coalface imply that almost all reported transactions are being accepted by trade repositories TRs, while matching and reconciliation rates also appear to be far higher than prior regulations and no cause for concern.

Industry participants have been clear that the three-month delay the market was gifted earlier this year contributed to this as it allowed for an extended testing period.

The below submissions offer a peek behind the curtain of what the period during go-live was really like. Many writers paint a picture of less a mad dash for the finish line and more a smooth launching of a new ship, though hopefully not that one. A few highlight some minor snags and bumps that had to be remedied in the first few days, while others immediately turned their attention to the future implementation waves on the horizon.

Without doubt challenges with SFTR remain, such as the still-clunky ISO schema and additional work to get buy-side clients up to speed in time for October, but overall the industry appears to have done itself proud.

Ron Finberg, compliance and regtech specialist, Cappitech

In the days leading up to SFTR going live, we found that our clients and internal teams were actually quite relaxed. The extension as a result of the COVID-19 pandemic gave the market the opportunity to do necessary additional testing ahead of go live. It's possible it would not have been as seamless with the original date. In particular, at the beginning of this year we'd had some concerns regarding how firms would manage the necessary updating of product identification and collateral details in time. But with a later go-live date, all our clients were able to have a process in place for this.

Once we went live, we were pleased to see that the preparation done by us and our clients mostly held up, with nothing that could be considered completely abnormal being flagged.

There were a few wry smiles when one client realised that throughout testing they'd been providing the wrong data – swapping borrower and lender details of their repos. But once this was worked out, the fix was easily made.

Prior to the go-live, one area that we did find wasn't as tested were client reuse reports.

This had been due to gaps in data capture and processes to account for recognising reuse between a few clients' dealing and compliance teams. For the go-live and to account for a lack of testing, our preparations incorporated time for running reuse files first in a user acceptance testing (UAT) environment before submitting to production. This ensured we could spot any problems before submitting.

What was particularly gratifying to see is the way the market, clients, vendors and TRs have clearly matured. SFTR wasn't our first rodeo - we've all seen other regulations go live - and we had a good understanding of what was needed in advance. It also meant that certainly, at go live, no one was complacent. On our side, we ensured we had plenty of specialist support available in that first week which meant that the small issues that did come up were quickly and easily corrected. We were also closely monitoring the technology we'd built, including volumes to support IHS Markit whose SFTR solution is powered by us.

This all-hands-on-deck approach is something we've all learnt is important, and certainly, clients appreciate the additional reassurance. While SFTR preparations were being finalised, we've also been extremely busy as we work to integrate new clients as a result of CME's departure from the market. But when the time came for SFTR to go live, our attention was focused on making sure that clients' kick off went off without a hitch.

Of course, once it was done, we celebrated with cocktails delivered to everyone's home address! It felt like rolling out a new reporting regime is now a comfortable, well understood process but raising a glass to its success was nonetheless satisfying and well deserved.

Cheers! Until the next regulation!

Jonathan Lee, senior regulatory reporting specialist, Kaizen Reporting

Like many of our clients, we were trying to get our testing services ready for one of the most complex pieces of legislation in the last decade and as if it wasn't difficult enough, the world goes into lockdown and offices across the globe closed.

While the go-live of SFTR will have been a huge relief for many project teams, for us it is really the beginning of the journey. This is because our services test the quality of data reported to the regulator. So while many might be popping corks, it is now full steam ahead for the team at Kaizen as we start to test the accuracy of the SFTR reports.

One question that was often asked by firms during the final stages of SFTR implementation is - have we done enough? The delivery of SFTR has been a long hard slog for everyone concerned and being one of the most complex pieces of regulation introduced in recent times, with up to 155 fields across 4 reporting tables and 10 action types, the lockdown only added to the challenge. That said in the eyes of many – ESMA included, for the initial implementation, firms have perhaps done enough.

For firms, there has been a lot of training, rules translation and interpretation of the regulation but never enough testing. The late publication of the guidelines in January only added fuel to the fire with relatively few questions answered and a number of new, quite fundamental requirements introduced that very few banks have been able to adopt in time. Therefore, it has been of critical importance to emphasise the need to document every decision made around the approach to reporting, defects and action plans.

Working with reporting counterparties, it quickly became apparent that now is not the time to rest on your laurels (much deserved summer break aside). Migrating SFTR from being a project into business as usual, writing procedures, preparing appropriate metrics, building a control framework, and establishing an error remediation process are all key to a successful marriage at the end of the honeymoon period.

What we have been seeing since the July go-live is that data quality is a major issue. If you cannot stand behind the quality of your own data, you cannot effectively challenge your counterparty when presented with reconciliation queries. Nor can you offer a credible, complete and accurate delegated reporting service when the buy-side goes live in October. Collateral reporting and the inability to match any collateral at all is in many cases a key pain point.

And this is what we at Kaizen are here to help with and why it's full steam ahead for us now SFTR is live for the first and second cohort of firms. Our team of data analysts and regulatory experts' hard work and endless hours in the office, and more recently at home, the endless Zoom calls that replaced a simple face-to-face chat, means that we are able to offer firms an independent-and comprehensive check of their SFTR reporting accuracy and have the confidence that they are fulfilling their reporting obligations.

Val Wotton, managing director of product development and strategy, repository and derivatives services, DTCC

Almost five weeks in and reporting of SFT continues to be successful.

Acceptance rates of transactions reported by firms has been very high; higher rates than initially achieved under prior regulations such as the European Market Infrastructure Regulation. We believe this was due to the fact that firms had more time to prepare for the regulation, following the three-month delay from April to July, and had been through prior trade reporting mandates.

Further, DTCC's testing environment was open for firms many months before the go-live of reporting, which helped them to be as prepared as possible for implementation. In fact, our UAT environment opened to vendors in August 2019, and market participants could begin testing in October, nine months before go-live. Furthermore, DTCC opened its pre-production environment in March 2020 which gave firms extra time to prepare.

In fact, as a testament to the success of SFTR implementation, firms are now able to focus their attention on the reconciliation of transactions. In the past, with other regulations, such as EMIR, firms waited weeks to address this particular aspect of reporting due to the need to ensure the successful reporting of data to the TR.

In addition to this, based on lessons learned from other regulatory reporting mandates, DTCC has worked even more closely with clients to continually educate and inform them on the operational aspects of reporting. Through our testing environment, we have been able to adopt a much more proactive approach, identifying and addressing any technical issues that we were then able to bring to the client's attention and resolve.

We were also able to provide our buy-side and sell-side clients with test packs to streamline their testing processes through our collaboration with Delta Capita. Lastly, earlier this year we launched Report Hub, a service which simplifies and streamlines the complex data and operational requirements of SFT reporting. As a result of these efforts, client feedback has been very positive – in our latest client survey, satisfaction rates were well above 90 percent.

In addition to our own efforts, a number of industry bodies including the International Securities Lending Association and ICMA have made significant contributions to promote best practice in helping market participants to comply with SFTR.

Notwithstanding these successes, there have been some technical challenges that the industry has faced, namely the ISO schema and technical guidelines which were issued a few months before go-live. This compressed the preparation timeline for market participants as the schema dictates how to report and any small change can significantly affect how a firm undertakes reporting. It is important that this is taken into consideration during the consultation on the EMIR Refit later this year.

Looking ahead, sell-side market participants are now turning their attention to finalising their operations to be able to support their buy-side clients who are opting for delegated reporting, with the exception of the reporting of collateral reuse which the buy side are beginning to realise can be achieved in-house. Of course, there are a large number of buy-side firms who will choose to report themselves – they too are now focusing on for the go-live in October.

Catherine Talks, product manager, SFTR, UnaVista:

In the run up to the SFTR go live we observed firms increasing the amount of testing that they were undertaking. In order to support firms we set up a series of daily calls to answer questions and discuss any issues that were occurring or where known. The weekend deployment of production changes in the system went well, we had pre-run the process a number of times in the previous month when deploying code into UAT and production so the process was well tested.

On Monday we started to receive production data. The acceptance rate, was quite surprising. We were expecting a higher number of rejections in the first weeks but the acceptance rate was above 90 percent and has consistently averaged over 90 percent in the following weeks. We had a number of support measures in place and have been actively reviewing TR submission data discussing with firms where the acceptance is under 80 percent in order to assist and improve in reporting performance.

The volumes of reports in the days since go live have been increasing which is expected behaviour but feedback from the market around the TR public data is that volumes are lower than anticipated. This could be due to an array of factors; the phasing of reporting, the backloading change under COVID or perhaps other factors.

The SFTR team has worked round-the-clock to help firms prepare for go live, right through the testing cycle and into production. I think we are all quietly pleased that the first two phases of firms have gone into production so smoothly but there is still much to do assisting firms in their preparations for the October reporting phase and beyond."

13 July will be long remembered by securities finance professionals as the go-live date for SFTR.

Jonathan Tsang, director, securities finance, IHS Markit,

The date would have been 13 April, however, ESMA announced a three-month delay resulting in the July date; the delay was fortuitous in that it gave stakeholders in the reporting process additional time to integrate some last-minute changes. The go-live date did finally arrive, and the collective years of planning were put to the test.

As we approached midnight on the 13 July, the team at IHS Markit mobilised to prepare the platform to ingest its very first SFTR files. The system opened at 2am London time and the first file that was received passed without any validation errors. The opening was smooth, all clients were well prepared as they had already tested in our pre-production environment. Crucially, we had no client connectivity issues. The only surprise was that we had anticipated more volumes on the first day considering what we had experienced in pre-production.

Our colleagues at Pirum were also at the ready and the first unique transaction identifiers (UTI) were shared at 2.51am and we made our first reports to the TR shortly after 4am.

Pairing and reconciliation are the primary challenges for the reporting requirement, so the focus was to ensure the smooth loading of client data in order to run through the solution and start the pairing process. This ensured the efficiency of the UTI and data exchange and clients were able to monitor this process carefully. The legal entity identifiers (LEI) of the issuer population is another challenge, however, a new opt-in feature will allow clients to minimise its impact.

One very positive item is our client services team responses and readiness; for months ahead of go-live, the mantra was to handle any queries in UAT as if it were production. We ran a support bridge for the first 48 hours of the roll-out to monitor the system and support continuous uptime. For the second week after go-live date we saw more than a third drop in the cases, with a very high rate of same-day closure.

Since 13 July, we have received around 10 million records daily, of which 750,000 to 1 million reports are submitted to the three TR. In terms of ACK ratios we see a very high success rate above 96 percent for transactions. The collateral ACK rate is more moderate and remains a challenge for some clients but this has improved since go-live as clients continue to make good progress with data remediation.

The challenges of SFTR compliance are both the massive scale of all securities lending and repo transactions as well as the intricate detail of matching, which is why so much focus and effort was required to prepare for the go-live date. Despite the updates to the regulation and the moving target of the go-live date, the collaboration with Pirum and our clients made the roll-out go smoothly with results to match the intensity of the preparation to deliver them.

Simon Davies, SFTR business development manager, Pirum Systems

Over the past few weeks, we have seen the first live trades being submitted successfully to TR. We are very pleased with how things went overall and feedback from the industry is that we are seeing a much better state compared to EMIR at the same point. Following the start of data loading to IHS Markit, our SFTR partner, on the 13 July, we started to receive data to pair between counterparts. The pairing rates we are seeing (this is prior to TR submission) have increased steadily since go-live as firms' bed down their submission processes and issues are identified and resolved.

The main cause of non-pairing on trade date is due to one side missing their booking. This is a combination of missing trades from counterparts, timing of the report submission, and reference data mapping (i.e. LEI set up and counterpart onboarding set up) that needs to be reviewed by firms.

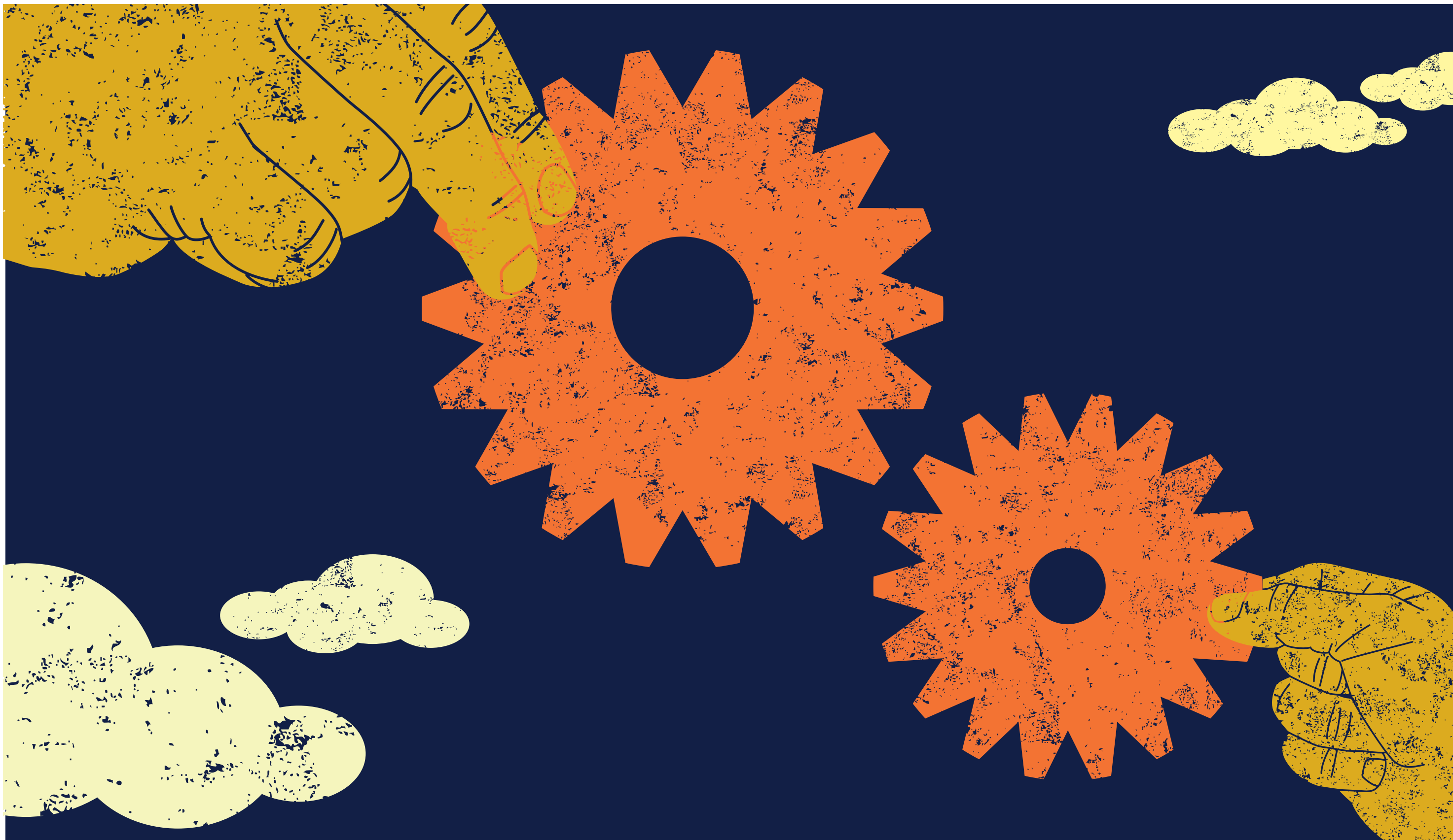
Given the critical nature of this in sharing UTIs and other information, firms have been working through issues and as expected, pairing rates are improving over time.

Whilst the pairing rates are looking reasonable overall and improving, trades with a fully matching data set are much lower. This is not unexpected from the pre go-live testing results and from conversations with clients, who have generally prioritised fields that are required for TR pairing (UTI, LEIs and master agreement) and validation of data to get good ACK rates. This is certainly pragmatic, but the missed opportunity to remediate data as part of the SFTR programme delivery is likely to provide a hangover for firms now they are live.

Core economic data generally matches; however, reference, static data, and pricing / valuation data are more likely to not match. As firms settle down with their reporting, we are discussing matching fields in more detail and how firms can use automation and workflow to prevent these breaks from occurring in the first place.

There has been a huge effort across the industry, led by the industry bodies, in understanding and working through the reporting challenges. Along with IHS Markit, we are proud to have been part of that effort and have been in a unique position to help bring together this work for the benefit of so much of the industry. We look forward to continuing with this beyond the initial go-live, and helping firms understand and resolve any remaining issues whilst we collectively work to improve industry metrics. This will ensure we have a better, more efficient reporting process for securities finance than has been achieved under previous regulations.

We would like to thank everyone involved at Pirum and IHS Markit, along with our clients for their input and support to get us to this stage. The feedback we have received to date has been resoundingly positive and that the implementation has been smoother than seen with EMIR and MIFIR. Given that many of us and our clients are working from home, collective celebrations will need to wait a while, but we're now able to take advantage of a quieter period to have a rest, recharge and get ready for phase three.



Panellists

Marc Poinsignon
Product manager - securities lending & borrowing, collateral management, banking, funding & financing
Clearstream

Farrah Mahmood
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ISLA

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Laura Douglas
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Clifford Chance

ISLA SRD II working group panel discussion

Contributors to ISLA's SRD II taskforce unpack what the incoming update to the Shareholders Rights Directive means for securities lending and what challenges await

How does SRD II affect the securities finance market specifically?

Farrah Mahmood: The second Shareholders Rights Directive (SRD II) is undoubtedly one of the most important regulatory changes to corporate governance in the EU in recent times, as it does not only impact Europe, but extends globally to any corporations that have their shares listed on a regulated market within the EU.

The biggest impact to the securities finance industry is the obligation on intermediaries, such as triparty agents and agent lenders, where it is now mandatory to assist and facilitate a company's right to identify a firm's shareholders, and facilitate the actioning of shareholders rights. This poses a huge operational burden on firms with regards to processing automated shareholder identification requests, in a standard ISO format, under specific time constraints, and whilst also managing additional volume of data and communications.

The definition of an 'intermediary' as defined under SRD II - ''a person providing services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or others, such as investment firms, credit institutions and central securities depositories'', is also open for interpretation to firms within the securities finance market, which has caused much debate.

Securities lending chains can often be complex, and under a title transfer agreement, all rights are passed to the borrower, including the right to vote. It is currently arduous for issuers to identify who their underlying shareholders are, and thus, the International Securities Lending Association (ISLA) fully supports the introduction of SRD II which will certainly help to improve overall transparency.

Marc Poinsignon: Securities financing transactions are known to play a pivotal role in supporting liquidity in the capital markets. Lenders and borrowers meet their funding and financing needs while mitigating their risks by exchanging loans of securities or cash against collateral assets. Whilst different contractual agreements are used by counterparts, for securities lending, loan securities are typically transferred from the lender to the borrower under a title transfer versus collateral under either title transfer or pledge (security interest) for the duration of the transaction. Such ownership structures and the custody arrangements are relevant in the context of shareholder identification requests.

At the same time, allowing the long-term investor in the securities to access corporate action information and to exercise rights is key. Established mechanisms exist to enable the lender and the collateral giver to recall their securities ahead of events.

Triparty collateral agents and intermediaries such as Clearstream facilitate the process and the ISLA SRD II working group is doing a great job in developing best practice guidelines.

Avinash Parmar: SRD II was designed to promote and increase long-term shareholder engagement and to improve transparency between issuers and the end investors of the shares.

From a securities financing perspective, once a security has been lent, all rights are transferred to the borrower including the right to vote, this has at times been a concern among asset managers in the securities finance market as it could lead to empty voting, even though there are codes of conduct and usually legal arrangements in place to prevent this. Under SRD II the increased transparency will help give more comfort to asset managers who lend their securities with the introduction of additional disclosure and regulatory reporting measures. However, these requirements will present challenges within the securities finance market, as it will now fall on any intermediaries to assist and facilitate in identifying and notifying underlying shareholders within the timeframes imposed under the directive.

In order to protect voting rights, lenders should/will retain the right to recall and restrict any securities. Securities can be recalled and restricted from lending until voting is concluded, thereby preventing empty voting (where the borrower can potentially act in a speculative way). This approach is aligned with the Principles for Responsible Investment (PRI) and the International Corporate Governance Network's Guidance on Securities Lending, as well as the European Fund and Asset Management Association's (EFAMA) Stewardship Code and Principle. SRD II in Europe should add further comfort and also add to oversight requirements.

By logical extension, asset managers are likely to increase their oversight on their securities lending programmes, with decisions around lending over record dates reviewed. This is likely to create additional control measures on lending activities be they in-house or through an agent lending programme including a review of lending criteria. So, process and controls will need to be reviewed, and this will feed into the ongoing discussion of securities lending and its role under an environmental, social and governance (ESG) lens. How firms run their securities lending and collateral management programmes, particularly with regard to return and recall management and fails monitoring, will also be challenged by the upcoming Central Securities Depositories Regulation (CSDR), with mandatory buy-ins and penalties for failing transactions becoming standard. We mustn't forget, however, that the European Securities and Markets Authority (ESMA) itself recently stated in December 2019 that "short-selling and securities lending are key for price discovery and market liquidity" and one recent high-profile case in Germany has only added weight to this statement.

Michael Brown: Although the securities finance market will feel the effect of SRD II in various circumstances, the impact on parties to a purely bilateral Global Master Securities Lending Agreement (GMSLA) structure is not dissimilar to the impact that will be felt by parties in other bilateral trading relationships or where relevant securities are held with a custodian. Additional impacts arise in the context of agent lenders (irrespective of whether they are an intermediary for the purposes of SRD II) and triparty collateral structures. Even for triparty structures, there are different concerns for parties operating security structures (e.g. for a Pledge GMSLA) and for traditional title transfer structures. In that context, it is perhaps unsurprising that ISLA has been working on template documentation in respect of triparty collateral managers and agent lenders.

ISLA's documentation seeks to remedy the tension between SRD II's requirements and the fact that the party with a long-term interest in the collateral is (absent a default) typically the collateral provider. As a result, the proposal is for information destined for shareholders to be passed on to the collateral provider in most circumstances, which will allow the collateral provider to determine whether it wishes to substitute the collateral and exercise the rights enjoyed by the shareholder on the record date.

Rickie Smith: One of the core objectives of SRD II is to improve the communication and interaction between issuers and long term investors, by establishing specific requirements to encourage shareholder engagement. The specific requirements impacting the securities financing market include 1) identification of shareholders; 2) transmission of information between issuers and shareholders, via intermediaries; 3) facilitation of the exercise of shareholders rights.

For each of the above requirements, SRD II imposes certain obligations on firms that fall within the SRD II definition of 'intermediary'. This is the first challenge, given the indistinct definition of an 'intermediary' per SRD II, which can lead to inconsistent conclusions for firms who are performing similar functions, when concluded if they are performing the role of an 'intermediary'. Per the regulation, in order to be an "intermediary", the entity must be providing one of three activities to shareholders in relation to "shares", namely: (A) safekeeping; (B) administration of shares; or (C) maintenance of securities accounts. It is therefore important that the services firms provide to their underlying clients are considered against this definition when concluding their analysis.

With regard to the shareholder identification (SI) requirements, any firm acting in the capacity as an intermediary is required to (1) respond to a SI request received from either the issuer, or another intermediary, and

(2) forward on the request to the next intermediary in the chain, should their underlying client themselves identify as an intermediary.

Speaking specifically from a triparty agent perspective, the securities finance market is particularly impacted with regard to European equities exchanged as collateral under a title transfer arrangement. The triparty agent, as an intermediary, will be required by SRD II to respond to the SI requests, identifying the shareholder on its books and records based upon the legal nature of the encumbered collateral holding. Given the frequent reallocations, recalls and substitutions, although the collateral holdings are not deemed long-term assets of the collateral receiver, the collateral receiver may be identified as the 'shareholder' based upon the ownership of the asset at the record date of the SI request. If the collateral receiver is acting as an agent on behalf of underlying beneficial owners, they themselves may then be considered an intermediary and be required to receive SI requests and respond with the underlying beneficial owner details accordingly.

Chris Markham-Lee: In the loan leg of a lending transaction, where securities move full title transfer to the borrower, the impact of SRD II is minimal. It is a standard feature of the BNY Mellon agency lending programme, that securities may be recalled at any time if a lender intends to exercise voting rights and we engage actively with clients to effect their recall policies. The GMSLA requires the borrower to take instruction from the lender with respect to corporate events other than voting, but that does not have an impact on SRD II obligations.

The less straightforward impact of SRD II on securities lending is in relation to collateral. In that case, the lender has taken collateral as a risk management device and is not an active owner and therefore does not expect to be engaged in corporate events or voting - in fact, they would only ever access that collateral upon a borrower default. The taking of the equities collateral is not an investment decision, as such. It has therefore been a matter of significant industry debate to reconcile the commercial realities of risk management through collateralised lending with the SRD II obligations, but as an industry I believe we have found the correct solution which upholds the spirit of the directive and ensures the right of investor shareholders to receive relevant information and exercise their voting rights.

A major challenge of SRD II comes from the fact it's a directive and therefore its terms are open to interpretation by the 27 member states. How big a challenge is this and what can be done to mitigate the problems this raises?

Parmar: With SRD II being a directive rather than a regulation, member states have some discretion on how the rules within the directive are transposed into their local laws.This certainly creates the potential for variations in the implementation of the directive. Furthermore, the directive contains certain provisions which will allow the member states to deviate in significant areas, such as the exclusion of certain transaction types. So, theoretically, each of the 27 member states can interpret and impose penalties for noncompliance that differ from the other states.

Additionally, the responsibility of identifying and notifying shareholders may also be unclear, as the definition of 'Intermediary' can be somewhat ambiguous within the directive. To help mitigate these potential problems, it is important for member states and participants to agree to best practices as a harmonised 'collective' group rather than individually. Raising awareness in working groups such as ISLA's SRD II best practice task force aims to identify and resolve parts of the directive that are open to interpretation and form consensus amongst participants.

Smith: This is true and poses a significant challenge for the industry to apply a consistent methodology when dealing with the requirements of the directive. One such challenge is that the directive does not define the term 'shareholder' and has left this to each member state to define through its own transposition into national law. Additionally, SRD II does not cover important elements of the operational processes required to ensure regulatory adherence. All these challenges have contributed to the creation of which has created a fragmented model when building solutions to adhere to the SRD II requirements and put a strain on technology builds and operational processes in having to meet divergent national requirements.

To address these specific concerns, industry associations have worked cohesively in drafting best market practises to agree upon standardised operational processes and workflows.

Markham-Lee: Whilst there are natural complexities associated with the national interpretation and implementation of the directive, the securities lending industry has moved forward through the forum of the ISLA SRD II Working Group, which has considered in detail any areas of divergence and legal interpretation. I think if we regard the spirit of the directive as the investor shareholder receiving the relevant information, then that is the approach to take, although some markets seem to allow the intermediary custodian to be regarded as the shareholder. From an agency lending perspective it is clear that if we are providing custody of collateral, we are the intermediary and our lender client is the shareholder when receiving equities on a full title transfer basis.

Mahmood: As many member states are yet to transpose the directive into national law, this has caused great uncertainty for implementation efforts. For example, where there is a contrast in the definition of a 'shareholder' in local jurisdictions. Where there is no consistency across the EU, ISLA feel that in many cases the information provided to the issuer will not reach the original objective of the directive of full transparency, and hence we will continue to advocate for a review to create standardisation across the market.

ISLA and its members support the industry task force's efforts to produce the recently finalised Shareholder Identification Market Standards, and will adopt many of these into our own best practices for securities lending.

In June, the European Commission's Capital Market Union High Level Forum issued a report proposing a review of shareholders rights by the end of 2023 to address the lack of harmonisation. This will most likely lead to a public consultation in which ISLA's SRD II working group can respond directly to securities lending specific nuances.

Poinsignon: The new requirements of SRD II aim predominantly at improving European corporate governance standards through, amongst others, increased long-term shareholder engagement and timely and transparent communication between issuers and investors. This impacts notably the whole chain of custody intermediaries who need to meet the requirements on shareholder identification, information exchange and exercise of rights.

The fact that member states may go beyond the standards and have diverging definitions or holding thresholds adds complexity which calls for an in-depth review and planning towards the implementation of agile and automated processes that manage the particularities. Since 2017, four European task forces have been tackling that issue and working on joint market standards for shareholder identification, general meetings and a golden operational record for corporate actions and general meetings, as well as ISO messaging standards.

Laura Douglas: The lack of harmonisation across member states is a particular challenge for intermediaries because the applicable law for determining who is considered the 'shareholder' depends on how SRD II has been implemented in the issuer's jurisdiction, not the intermediary's jurisdiction. Member states are also not uniformly aligned on other points, such as the optional de minimis threshold for shareholder identification and the possibility of prohibiting intermediaries charging for their services. In addition, some member states have 'gold plated' the SRD II requirements on intermediaries, for example, by extending their application to non-equity instruments. As a result, many intermediaries need to be ready to comply with a range of different rules for the various securities that they provide services in respect of.

The High Level Forum on Capital Markets Union recognised the challenges posed by this lack of harmonisation in its final report published in June and recommended that the commission should therefore introduce an EU-wide definition of 'shareholder' for this purpose and further harmonise the rules on shareholder identification and exercise of shareholder rights. However, the report envisages that these changes should be agreed by 2024 and so unfortunately they will not assist intermediaries seeking to comply with the current SRD II requirements.

The letter requesting a delay to SRD II was signed by 11 trade bodies. Does this mean that a broad spectrum of the market is struggling to meet the September deadline?

Douglas: The fact that the letter requesting a delay was signed by 11 trade bodies from across the financial markets underlines how many different business areas and documentation sets are impacted by these requirements. In addition to the challenges posed by the COVID-19 pandemic, a key concern highlighted in that letter was that various member states had still not finalised their national implementation of the SRD II intermediaries requirements, giving very little time for intermediaries to take into account all the different member state approaches to implementation ahead of the September deadline. Most member states have now finalised their implementation of SRD II intermediaries requirements, alleviating this concern to some extent, but the short timeframe between finalisation of some of these requirements and the implementation date remains a challenge.

Poinsignon: A broad range of market participants are impacted including EU issuers, intermediaries, institutional investors, proxy advisors and more. Firms that have struggled to analyse how it impacts their activities and implement changes have had to play catch-up with very little time remaining.

Markham-Lee: Initially the delay was requested due to the immediate issues raised by COVID-19, causing resources to be stretched across the market, at the same time as other significant EU regulation was coming into force – namely the Securities Financing Transactions Regulation (SFTR). However, despite the working from home environment, there hasn't been any compromise in meeting regulatory deadlines.

A lot of work has gone into the ISLA SRD II Working Group discussions and as a result, the industry is preparing to meet the required deadline. I have also been heartened by the focus from ISLA, Clifford Chance and industry participants to give this directive the real attention it deserves in the required timeframe.

Mahmood: As so many firms will be impacted by this directive in September, it has certainly not gone unnoticed as to the vast impact of SRD II to the securities finance industry and the wider market.

In terms of the sheer volume of data processing as per the requirements of article three, firms will require additional resources and technology builds which have been somewhat constrained heavily by the COVID-19 pandemic. The directive is also open to interpretation, and therefore eleven trade bodies felt it necessary to request a delay, highlighting the weighty impact to various firms.

Smith: Despite market participants making every effort to prepare for the implementation of SRD II, it is unlikely that the objectives will be fully achieved. The main concerns highlighted from the market are the divergent national transpositions of SRD II having a practical effect of requiring different operational processes in order to comply. This coupled with the legal risk arising from the uncertainty of requirements within certain EU countries (i.e. definition of shareholder) is a concern and also proving difficult for market readiness.

Parmar: With several regulatory legislative measures such as SFTR coming into play during 2020 and the widespread disruption caused by COVID 19, many member states and market participants have voiced concerns about their ability to meet the 3 September deadline, which is reflected in the significant number of trade bodies lobbying for a delay in the implementation timeframe. As we have seen with delays to Uncleared Margin Rules (UMR) and CSDR, the industry would welcome a reasonable delay, given unanticipated challenges of 2020.

How much of an issue is that the delay request was rejected?

Mahmood: The eleven associations that signed the letter requesting a delay (including ISLA), have established the necessary best practice requirements for the go live in September, and we will continue to advocate on this topic in the future.

Smith: There is no doubt that the delay would have allowed for more time to work through and address some of the specific concerns and issues with the regulation, however the industry has to now fully focus on being ready to comply by 3 September.

Poinsignon: Impacted firms have limited room to enhance and finalise their solutions prior to the deadline which may entail that greater process and messaging efficiency may still be achieved afterwards.

SRD II will challenge custodians to communicate much more rapidly and effectively with their underlying clients than they currently are. What are the hurdles in achieving this?

Markham-Lee: As a custodian and agent lender, BNY Mellon prioritises engagement and communication with clients in all areas of the investment lifecycle. The ability to provide the required information to clients has always formed part of a good custody service offering, appreciating that different clients require differing levels of service on proxy voting, in particular.

One area of uncertainty which arose in the interpretation of the directive is the ability of a client to 'opt out' from receipt of information required by the directive. However, in assessing the spirit of the directive, there is general industry consensus through the ISLA SRD II Working Group that there should not be an opt out, but that instead all clients should be set up for proxy voting services and should receive corporate information, though they may choose to delegate such receipt to another party.

Brown: In practice the challenges are both operational and legal. Systems need to be in place to ensure that all intermediaries can react in the required timeframe and this requires both operational readiness and contractual agreement between all relevant parties. As custody chains increase in length this can put greater strain on the operational requirements.

The operational hurdles are greater where a service provider would not traditionally provide a full range of custody services but which would be caught by the definition of intermediary in SRD II. Equally, more complex legal questions arise if there is a conflict between SRD II and the laws of a jurisdiction outside the EU, for example laws relating to banking secrecy or confidentiality requirements. Such conflicts are not unique to SRD II and memorably arose in respect of transaction reporting requirements but it will take time and careful analysis for a solution to emerge.

Poinsignon: To support the key objectives of the directive, intermediaries along the custody chain have had to assess operational impacts to meet the requirements and tight processing deadlines (generally one business day) while catering for different national law requirements. The level of transmissions and communications is expected to increase and one challenge from an industry standpoint has been to increase straight-through processing. In turn, this has paved the way for a greater adoption of the ISO 20022 messaging standard. Clearstream, as an intermediary in the holding chain, is supporting its customers' globally to mitigate the impact and be compliant.

Parmar: The ability to identify, transmit information and facilitate the exercise of shareholders rights under the directive presents many challenges, particularly with the reliance on intermediaries to cooperate in the timely identification of shareholders and facilitating the exercising of their rights.

Custodians will need to have sophisticated machine readable (ISO format) methods of communication to disseminate meeting and agenda details to their clients, capture voting preferences, instructions, receipts and confirmation statuses if they are to adhere to the timeframes imposed under the directive.

The need for improved technology to standardise and automate the processing of meetings, proxy voting and shareholder identification is a challenge that both custodians and intermediaries must consider as part of their obligations under the directive.

Technology will play an instrumental role in the ability to identify and transmit data to shareholders and new technologies such as distributed ledgers could be leveraged and potentially assist in the directive's transparency requirements however more analysis is likely required. Therefore, custodians and their clients will need to embrace the changes that this will drive and look at replacing legacy technology in order to deal with these changes.

Smith: Custodians play a vital role in the financial system providing investors access to entitlements in securities issued by companies and services necessary to give effect to investors' rights in these securities. Having an automated workflow process is paramount in ensuring that custodians (including us as tripary agent) can quickly facilitate requests between issuer and shareholder. There are a few third party vendor solutions that have carried out extensive development work in order to offer an outsourced solution, improving the speed in which information can flow through the intermediary chain.

The main hurdles that still exist are a result of the inconsistencies across numerous EU member states transpositions, which have created a divergent operational process in order to comply and will, in the absence of a EU standardised approach, continue to cause issues.

How much do these difficulties come from the requirements of SRD II itself and how much of it is related to the fact SRD II comes into effect alongside several other major regulations and follows the major disruption caused by COVID-19?

Smith: Whilst the impacts of COVID-19 have been felt across the industry, and we have seen delays to the implementation of other regulations, the difficulties are less related to these factors and more driven by the interpretation and harmonisation considerations mentioned earlier.

Parmar: With Brexit dominating much of the European political agenda for 2019 and COVID-19 causing widespread disruption during 2020, coupled with the fact that that key regulatory reporting initiatives such as SFTR, the Refit of the European Markets Infrastructure Regulation (EMIR), CSDR, UMR alongside SRD II were planned for this year meant that it was always going to be a testing year for many institutions to meet the planned deadline

The challenge in the SRD II directive is in its reliance on multiple chains of intermediaries working cohesively in; 1) effectively identifying and facilitating the exercise of shareholder rights in addition to their disclosure obligations and 2) the agreement with whom the responsibility at each stage of the process sits with. Once there is consensus around these issues, the challenge will then be ensuring that the technology is in place to support the communication from issuer to shareholder.

Poinsignon: SRD II has come with its challenges as the industry has been working on its implementation. At the same time, resources have been mobilised by other regulatory deadlines and put under pressure by the COVID-19 disruption obviously. It is at times like these that market participants most need to rely on reliable partners that can support them and develop 'future proof' operating models.

Brown: The fact that SRD II touches on so many different business lines and documentation sets inevitably leads to a more complex implementation and the difficulty only increases when resources also need to be allocated to other high profile regulatory projects while dealing with market disruption from COVID-19.

Much like SFTR and CSDR, it could be argued that SRD II is a burden now but may ultimately force the industry to evolve in ways or at a speed it might not have done otherwise. Do you agree?

Douglas: It is certainly the case that SRD II is prompting intermediaries to change the way they transmit information between shareholders and issuers. The hope is that these new requirements will result in improved transparency and efficiency in relation to shareholder identification and shareholders' ability to exercise their rights. However, the lack of harmonisation means that the potential benefits to issuers and shareholders may not be felt evenly across the EU.

Poinsignon: Rights of shareholders and to a certain degree those of issuers are at the heart of SRD II. Transparency, strong corporate governance and long-term engagement by investors are at the forefront of many conversations. As always, the financial industry continuously looks at ways to improve itself. Embracing such regulation can also prove to be an accelerator in increasing operational efficiency through more standardisation of messaging (ISO 20022), automation and enhanced connectivity solutions.

Clearstream has been actively participating in working groups at both national and pan-European levels to ensure that forthcoming changes contribute to these objectives. It should, however, be noted that many EU member states have still not adopted SRD II into their own national laws.

Mahmood: ISLA fully endorses the objective of SRD II and the efforts of regulators to promote long term corporate governance across Europe. Empty voting is often labelled as a concern for institutional investors and issuers, however the transparency that this directive will bring only encourages shareholder engagement further, and will create more robust stewardship of companies.

The association of short termism to the securities lending industry in particular is also diminished under SRD II requirements, in which asset managers must disclose to institutional investors their use of proxy advisors, and their policy on securities lending to the regulator in order to promote a greater dialogue between issuer and investor. The full benefits of SRD II, however, will not be met until the shortcomings are resolved by public review.

Parmar: As with all new regulatory reporting requirements, there is always a challenge in being prepared in the timeframes imposed by the regulatory bodies due to limited resources to interpret and implement such initiatives. Although without such a political or regulatory push, this scale of change is unlikely to occur as quickly or even at all.

The intention of the first SRD in 2007 was primarily, to encourage shareholder engagement in the long-term and for transparency of institutional investors, asset managers and proxy advisors. SRD II further builds on this directive and with 2020 being a crucial year for ESG activities and evolution, SRD II will assist the industry in ensuring that measures are being taken by firms to disclose the necessary information that is required under the directive. This will evolve the way in which industry participants act and compliments the sustainable finance disclosures that firms will need to factor in as part of their ESG policies in the future.

Smith: In general terms yes I would agree, however in order for the major objectives of SRD II to be achieved there needs to be a mechanism that introduces certain commonalities to address the divergent operational processes and legal interpretations throughout the EU member states.

Ina Budh-Raja
Director, EMEA, head of product & strategy, securities finance
BNY Mellon

As the focus on ESG grows in importance for our clients and other industry stakeholders, there is also a growing recognition that securities lending has a critical role to play in furthering the sustainable finance agenda by enhancing market liquidity. Securities lending is well-recognised as being an important driver of efficiently functioning markets, for its role in promoting market integrity, and today the sector is inherently entwined with ESG objectives. BNY Mellon works closely with clients to ensure our agency lending programme is adaptive to their key governance needs, so that they are able to provide evidence to their stakeholders how securities lending can help them to meet their long-term ESG objectives.

As an integral part of the EU sustainable finance and ESG agenda, SRD II is aimed at increasing transparency and encouraging long-term stewardship and shareholder engagement. The directive has been received positively by several international initiatives for sustainable investing, including the UN PRI, on the basis that these new rules are in line with the six UN Principles, particularly Principle 2, regarding the need for active owners to adopt ESG issues into their policies and practices.

BNY Mellon supports the introduction of SRD II as a further safeguard to investors, providing an additional level of transparency to clients engaging in securities lending in a well-governed, thoughtful manner, as long-term stewards of their assets. SRD II introduces more robust corporate notification requirements, which will further enable investors to be better equipped when applying their ESG policies. On governance and voting, for example, SRD II is enabling investors to make well-informed decisions concerning voting on issues material to their ESG strategy, whether that be on diversity and inclusion issues, environmental and climate change matters, human capital management, cybersecurity, business ethics, or other issues.

In terms of adoption by the securities lending industry, whilst there have been potential challenges given the areas of divergence in national application of the rules, timing of implementation and interpretation of the directive, the industry has come together through the ISLA SRD II Working Group, led by Tina Baker and Farrah Mahmood, to effectively debate and develop best practices to meet the requirements of the directive and uphold the spirit of the new rules. The ISLA Working Group has played a critical role in formulating harmonised best practice guidance for the market, which will ensure that this industry stands ready to meet the 3 September implementation date.

Against the clock

Ronen Kertis, founder and CEO of Cappitech, discusses why the closure of CME's regulatory service could cause the price of reporting to rise and make firms rethink what they look for in a provider

Natalie Turner reports

What are the key challenges market participants face with this shift in the market?

The CME announcement was a shock for much of the market and it was quickly clear that it would be very important to ensure that ongoing regulatory processes will need to continue uninterrupted. A seamless transfer is therefore absolutely central to firms' considerations.

Of course, the need to take on a new regulatory process, including onboarding with a new vendor and/or trade repository (TR)/approved reporting mechanism (ARM) also adds a burden to firms at an already difficult time. Limited resources and budgets, along with time constraints, are all adding pressure to firms as they consider their options.

For vendors and other TRs and ARMs, there will be the need to prepare to handle the additional volumes as a result of this migration. This is particularly true under the European Markets Infrastructure Regulation (EMIR) which requires full history porting from the CME to the new TR.

What is likely to be the biggest impact of CME's departure?

Inevitably, pricing is likely to change following CME's departure. CME has historically been the most competitive on pricing, so the average price of trade reporting will immediately increase. Necessary ongoing investment is also likely to impact price and the CME's departure strongly suggests that the lower price was unsustainable. Costs are impacted by the huge volume of data involved in reporting, the need for quality technology and services and the cost of complying with evolving regulatory requirements. Having said that, vendor pricing will remain lower than the total cost of ownership for a firm developing its own solution and vendor solutions will benefit from being able to share the build cost among clients while simultaneously ensuring a better product, partly as a result of collaboration.

If price becomes the key factor, service is likely to be negatively impacted as firms reduce investment to meet lower cost demands. However, we are optimistic that if a fair market price can be established, clients will focus decision-making based on the quality of service and products on offer, driving the development of high-quality service and the introduction of improved products that meet client requirements.

Are clients likely to continue to use vendors or shift to working directly with TRs and ARMs?

Many firms like the idea of shifting directly to TRs but there are challenges around the technology required and the potential effort involved when new technology becomes standard or regulatory changes take place. Implementing this in-house is often difficult and expensive. Two months since the CME announcement, we're seeing a lot of clients settle on the idea of continuing to use a vendor, but doing so with very clear requirements and long-term key performance indicators to help them manage change over time.

What are clients most focused on as they look to review their processes and service providers?

Data transformation and porting is probably the single most important consideration in the first instance. Data porting is, technically, one that needs to be dealt with between the CME and the new TR but the sheer volume of back data may cause problems if not done sufficiently in advance.

When submitting data to a new TR/ ARM or vendor, clients want to be able to provide the same raw file they were sending previously, requiring less work to adapt to a new provider and making it more likely that they can meet the deadline.

Clients are also very interested in ensuring that their vendors are ARM/ TR agnostic. The CME's departure has highlighted the potential risk of other changes in the market's infrastructure and firms want to be confident that they have multiple end-points connectivities to reduce longer-term effort and risk.

As clients start the review process, they're also demonstrating a strong interest in where they can build in new services and other improvements in terms of efficiencies, cost, added value etc. It's a real opportunity to enhance their processes.

Are there opportunities for improvement as a result of this change?

Clients are definitely taking the opportunity to enhance their processes. Many are reviewing their options with the mindset that they're looking for better technology or an improved product offering. In particular, we're seeing a lot of client interest in additional features that are embedded in vendor offerings such as increased automation and improved business insights, all of which support the original intentions that underpin many regulations.

This is also proving to be a good opportunity for firms to enhance their review and monitoring processes. First by reviewing existing processes to ensure they're collecting the right data and can identify and remove any in-built errors. Longer-term, improved control functions are a feature of many offerings which provide dashboards and analytics to monitor reporting processes.

Will CME's departure change how clients consider their service providers?

A key shift is that clients are considering the ramifications of future similar changes and are looking for solutions that are future-proofed as much as possible.

Firms are also looking for assurance that their vendor is financially stable and has intentions to stay in the reporting sector for the long term.

What is the impact of CME's decision on firms who were about to start SFTR?

The CME Group is supporting SFTR reporting until their November exit date. Beyond that time, firms will need to report directly to their TR or find a replacement vendor to provide data conversion and SFTR submission services.

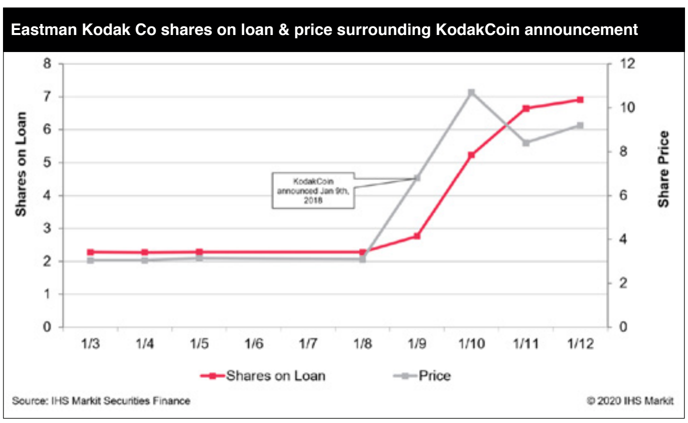
Encore for Kodak shorts

Sam Pierson
Director
IHS Markit

Short sellers are betting on iconic US camera maker's decline (again). IHS Markit's Sam Pierson surveys the situation

On 8 January, 2018 Eastman Kodak Co shares closed at $3.10, its value having declined by 80 percent over the preceding 12 months. Over the next two days the shares more than tripled in value, closing 10 January at $10.7; Insufficient to offset the losses over the prior year but a boon for long investors, nonetheless. The cause of the about-face was the announcement of KodakCoin (see Figure 1), a partnership the firm was forming to develop a blockchain cryptocurrency solution for payments to photograph rights holders.

Figure 1 *Source: IHS Markit Securities Finance*



A tripling will cause problems for short sellers. The pain of the unrealised loss is compounded by the loss making position having grown in nominal terms and as a percentage of the (now smaller) portfolio. For the prospective short seller, however, a tripling may be a most welcome entry point, as was the case in for KODK shorts in January 2018. The short interest reported by NYSE for 29 December 2017, the most recently reported as of 10 January, stood at 3.2 million shares. The 12 January short interest would later be reported as 12.2 million shares, a 276 percent increase.

On 10 January the number of borrowed shares reported to IHS Markit more than doubled to 5.2 million shares, while the fee for new borrows increased from < 50bps to more than 5,000bps. The increase in borrow fee was published intraday on 10 January and the net increase in shares on loan reported the next day on 11 January. The 12 January NYSE short interest number was not published until 25 January, by which time the share price, shares on loan and borrow fee were all in decline from the 22 January peak. By August of 2018 the KODK share price was back below where it was prior to the KodakCoin announcement.

The same-day spike in borrowing on the day of the KodakCoin announcement highlights a key subtlety in how the data is reported. The short interest data published by the exchanges is purely tied to settlement date, so the 12 January short interest number pertained to trading on 10 January.

The securities finance data will function similarly, in that changes in borrowing will usually reflect changes in the settlement needs for that night, i.e. trade date +2. However, Kodak provides an important caveat. While broker-dealers generally borrow shares for today's settlement needs, they are also managing an internal long supply of shares which they may lend out to their own clients or other brokers. If a broker had rehypothecated KODK shares prior to the KodakCoin announcement the combination of soaring volume and volatility, increased locate requests and surging borrow cost may have compelled the broker to borrow in shares today to cover the existing short position, suspecting that the long position may be sold and marginal borrow may be even harder to come by tomorrow so getting ahead of today's locate requests may be worth doing anyway.

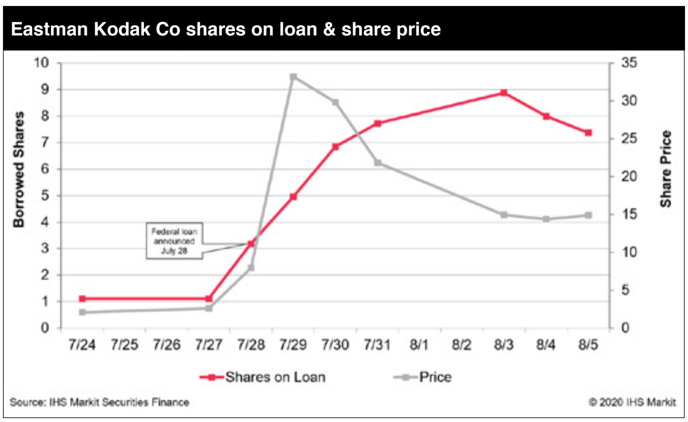
Shifting forward by just over two years, amid the so-called 2020 COVID crash the KODK share price closed at $1.55 on 23 March, the lowest point since the firm went public via an initial public offering in 2013 (as a result of bankruptcy reorganisation). The KODK share price subsequently recovered along with the broader market, increasing by 35 percent from the low close in March to the close on Friday, 24 July.

The following Monday, 27 July, the share price increased by 25 percent with no obvious catalyst. On Tuesday, 28 July, Kodak announced via a press release that they would be receiving a loan from the US government to develop capabilities as a provider of discount generic drug materials. In reaction to the news the share price increased by just over 200 percent to close at $7.9 (the highest closing price since 31 January 2018) (see Figure 2).

Like the January 2018 episode, the rapid ascent in share price was painful to existing shorts; The 1.7 million in short positions (reported by NYSE as-of 15 July), increased in value by an estimated $3.5 million on 24 July to $56 million at the peak. Also echoing 2018, short sellers immediately added to outstanding short positions, both on the 28 July and over the next week as the share peaked on the 29 July and started to descend, reaching 8.9 million shares on 3 August. The 31 July NYSE short interest was published on 11 August at 8.6 million shares. The borrow fee peaked at 16,000bps (an annualised rate of 160 percent) on 30 August and subsequently declined with shares on loan; New borrows were back under 2,000bps on 13 August.

"You Press the Button, We Do the Rest". So said an early slogan for Kodak, in 1888. That phrase would work as well for brokerage firms in 2020, given the surge equity trading activity. The outperformance of hard-to-borrow US equities starting in April exceeds even the rally from the depths of the GFC in early 2009, with filing for bankruptcy appeared temporarily to be a positive catalyst. The resurgence of Eastman Kodak Co fits perfectly into the broader narrative, however, specific risks exist for investors on the long and short side. Shares of KODK closed on 13 August at $9.2, down 72 percent from the peak close on 29 July, though still up 338 percent from the close on 24 July. Shares on loan have decreased by 1.9 million shares since 3 August, suggesting some short sellers are pocketing gains, while most short sellers who entered positions after the loan-announcement await further developments to cover their positions. In 2018 short sellers were rewarded for maintaining positions after the initial reversal, however, little about the short selling in 2020 has been grounded in precedent.

Figure 2 *Source: IHS Markit Securities Finance*



Sam Pierson
Director
IHS Markit

Upcoming Securities Finance Training

Advanced Securities Lending

Date: Get in touch for dates
Location: Online
Provider: Consolo

A two day course that builds on a basic understanding to consider the current market as well as future developments and initiatives European Market Infrastructure

SFTR

Date: 26 August 2020 17:00 (BST)
Location: Online
Provider: Consolo

This live online training course is designed for anyone who needs to know the background, structure, reporting obligations and timeline for delivery of the European SFT Regulation

European Regulation Impacting Securities Lending

Date: 19 August 2020 17:00 (BST)
Location: Online
Provider: Consolo

This live on-line training course is designed for anyone who needs to know the background, and application of core European regulations

Corporate Events in Securities Finance

Date: 09 September 2020 08:00 (BST)
Location: Online
Provider: Consolo

This live on-line training course is designed for anyone who needs to know the background, structure and obligations of Corporate Events in the Securities finance industry

Comings and goings at Delta Capita, Handelsbanken and MUFG

Per Stromberg has been promoted to team leader of securities finance at Handelsbanken Capital Markets as part of a widespread reorganisation of its equities business.

He will be reporting to Olof Werneman, head of equity and commodity execution.

This spring, Handelsbanken carried out a reorganisation and merged all groups within the equity trading business to have more efficiency and better solutions for our core business. Within that group it has appointed a few team leaders and Stromberg was appointed for the securities finance team.

Stromberg has served for over 11 years at the same bank in a variety of roles, his most recent position was equity finance trader, he held this position for just over eight years.

Prior to that, he was a structured products market maker in 2011 for a short period of time, before then he also served a short term as trading assistant execution.

Stromberg began his career at Handelsbanken in June 2009 where he worked in derivatives operations.

Cowen, the financial services firm, has hired Joseph Genovese to join the firm as its managing director and head of Delta One swap sales.

Genovese, who will be based in New York, will be responsible for client origination for Cowen's portfolio swap product and will report to Matt Baldassano, managing director and head of global securities finance.

The seasoned prime brokerage professional comes to Cowen with 25 years experience under his belt in finance and prime services.

Prior to joining Cowen, Genovese spent 16 years at Deutsche Bank where, most recently, he served as head of global prime distribution for the Americas.

Previously, he spent five years at Credit Suisse in their prime finance group and four years with Bear Stearns's prime brokerage division as a client relationship manager for hedge funds.

"We are excited to have Joe as a new member of our team and dedicated to bringing new relationships to our financing offering and the firm," says Baldassano.

Commenting on his new role, Genovese adds: "Cowen's momentum, track record of success, global footprint and deep senior relationships with buy-side portfolio managers present an exciting opportunity. I have been watching their outstanding growth and am excited to join the team to help further build out this critical part of the business.

"Cowen's portfolio swap products offer an excellent opportunity for alpha generation and risk management and I look forward to working closely with the team to identify opportunities for our clients to outperform."

The hire comes shortly after Cowen prime services expanded its business development team by hiring Michael Fitzgerald as its managing director.

Repo veteran Marco Hosenseidl is promoted at Commerzbank to head of secured funding and collateral management.

Hosenseidl, who is based in Frankfurt, has served at Commerzbank for over 24 years in various repo roles.

Prior to his promotion, Hosendseidl had been head of repo execution since 2016, specialising in global liquidity and risk management.

Before then he worked as a repo trader from 1996 working on the short term interest rate trading desk.

MUFG Investor Services has recruited the services of JT Zamecnik as a securities lending trader.

Zamecnik, who is based in New York, joins from Deutsche Bank where he served for just over three years in two positions, most recently, a global markets transaction and routing analyst and in 2016 to 2018 he worked as a securities lending analyst.

At MUFG, Zamecnik joins former-Deutsche Bank colleagues in a division headed up by Tim Smollen, global head of global securities lending solutions.

Since MUFG appointed Smollen to lead the charge in revitalised securities lending mission he has steadily brought on a large contingent of his former Deutsche Bank team which includes Jay Schreyer, former head of agency lending for Europe, the Middle East and Africa, and Asia Pacific, and Anthony Toscano, former co-head of agency lending for North America.

The hire comes alongside the news that MUFG has signed up to use EquiLend Spire as the technology foundation of its new-and-improved securities lending business that Smollen was brought on to overhaul.

TP ICAP Group, an interdealer broker and market infrastructure provider, has appointed two senior roles in its data and analytics division in a bid to diversify its offering and capture more buy side users in Asia.

Rhys Spencer, who is based in Singapore, has been promoted to the newly-created position of head of sales, Asia, after more than a decade as part of TP ICAP's data and analytics division.

Spencer will focus on implementing a talent acquisition strategy to establish a team focused on growing revenue from client segments including asset managers and hedge funds.

Elsewhere, Jeff Missimer, who is based in New York, joins TP ICAP in the additional new role of head of sales Americas.

He brings more than 25 years of experience, including his most recent position being head of sales Americas at Bloomberg Polarlake.

Missimer's focus will be on data and analytics ambitions to grow its offering in the buy-side and energy and commodities space.

Delta Capita names new head of regulatory change and technology

Delta Capita has appointed Karan Kapoor as the new head of regulatory change and technology, based in London.

Kapoor brings more than 10 years of bank regulation-driven business and technology change management experience, spanning the Central Securities Depositories Regulation (CSDR) Dodd-Frank, the second Markets in Financial Instruments Directive (MiFID II), Basel III and the European Market Infrastructure Regulation (EMIR).

Most recently, he managed the CSDR initiative at a global investment bank where he led a team to quantify the commercial impact of the CSDR settlement discipline regime, whilst supporting the design of target state technology and process solutions to deal with penalties and mandatory buy-ins.

At Delta Capita, Kapoor will help clients benefit from the firm's digital assets and CSDR project accelerators such as DC-Transform and DC-Modus.

Commenting on his new role, Kapoor comments: "This is a great time to be joining Delta Capita following the recent Prytek investment. In the short term, I will be leading our CSDR delivery services where Delta Capita has some great technology assets to help banks track, trace and monitor operational breaks throughout the settlement workflow. Looking forward I am excited to be helping shape and build out Delta Capita's strategic managed services."

Steve Vinnicombe, head of Delta Capita's global consulting unit, adds: "As we evolve our offering to be driven by technology assets and deep industry knowledge, Karan Kapoor brings a wealth of relevant experience in regtech as well as bank operational efficiency, finance and risk data transformation and specific regulatory regimes. We are delighted to welcome him to the team."