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Issue 263 13 October 2020

Forging ahead

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White Paper

The RMA says the securities lending industry is not yet ready for widespread adoption of digital assets

CMU Update

The EC's new action plan is giving securities finance participants fresh optimism that their regulatory headaches may soon be soothed

Panel Discussion

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Reporting data integrity undermined by LEI lapses

As much as 30 percent (500,000) of legal entity identifiers globally are out of date and in need of renewal, according to LEI Worldwide, a GLEIF-registration agent and LEI provider.

LEIs are a 20-character alphanumeric code that, as the name suggests, allows regulators to identify individual counterparties in a transaction.

They are currently required under several rules frameworks including the Securities Financing Transactions Regulation and the European Market Infrastructure Regulation, among others.

LEIs require annual renewal. When an LEI has been renewed within the last year the status shows as ‘active’ if it has not been renewed it will show as ‘lapsed’.

“Having a lapsed LEI can have profound consequences,” explains LEI Worldwide director Darragh Hayes. “It means the data may be out of date, and therefore cannot be relied upon by regulators.”

With regulations in place, it should be standard procedure to check on the status of your LEI before submitting any transfers or purchases, he argues.

Hayes adds: “In the event of a lapsed LEI intermediaries and regulators can block your transaction. This would cause unnecessary delays and unwanted disruption.”

In response, LEI Worldwide has launched a new search tool to allow users to more-efficiently validate the LEIs of their firm and its counterparties.

The search tool is an application programming interface which feeds into a database housing more than 1.7 million LEIs and provides a real time searchable index for every entity.

LEI Worldwide has also implemented a programme that conducts a spell check upon search.

Continued on page 6

Inside this issue

White Paper
Digital asset corporate actions
23 The RMA's Financial Technology and Automation Committee says the industry is not yet ready for digital assets

CMU Update
Reg Wars: A new hope
28 The EC's new action plan is giving the market fresh optimism that their regulatory headaches may soon be soothed

Automation Innovation
A new collateralised world
30 Chris Walsh, CEO of AcadiaSoft, discusses the impact of COVID-19 on collateral management by accelerating automation

Lead Feature
Forging ahead
18 GLMX COO Sal Giglio offers insight into the platform's new products, senior hires and future plans for growth in a post-COVID world

Panel Discussion
Green is the new black
33 Members of ISLA's ESG working group and Council for Sustainable Finance describe how responsible investing has taken centre stage in the fightback against COVID-19

Data Analysis
Securities lending Q3 review
39 Global securities lending returns declined 28 percent YoY in September

Industry Appointments
Comings and goings at Standard Chartered, Clearstream and TP ICAP
43

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Reporting data integrity undermined by LEI lapses

continued from page 3

This allows the programme to pick up on any spelling errors or typos and provide a list of suggested results which can allow you to find what you are looking for more easily.

With this tool, any company can search for their LEI and renew it immediately by clicking the renew button which appears in the search results, which is a unique feature, according to Hayes.

The LEI search tool is publicly available and free to use. It is most commonly used by both regulators and the owners of LEIs, says Hayes.

Before the new LEI search tool, LEI Worldwide would manually respond to customers requests about an entity or an LEI.

It had a notification on its website that any LEI checks or entity checks could be conducted by contacting its support team who would look into it for them. They would also suggest renewing the LEI if needed.

Last week, the Commodity Futures Trading Commission fined Morgan Stanley $5 million for a range of swaps reporting failures between 2013 and 2018, including incomplete LEIs.

"Upon further investigation, we realised that Morgan Stanley Capital Services had a lapsed LEI between 2013 and 2018. It is quite simple to renew the LEI, and it is possible they did not realise it had lapsed," says Hayes.

Global securities lending revenue continues to underwhelm

The top-five revenue-generating securities in the global securities lending market for Q3 generated less than half the income for lenders compared the top five securities in the same period last year, according to DataLend, the market data division of fintech EquiLend.

Varta AG, Nikola Corp, Carnival Corp, Canopy Growth Corp, and Inovio Pharmaceuticals generated $106 million for the global securities lending market in Q3, compared to $284 million earned by the top-five securities in the same period in 2019.

This figure represents a significant decline from Q3 last year when loans revenue for Beyond Meat, 2019's top earner, brought in $120 million over the three-month period on its own.

In total, the global securities finance industry generated $1.77 billion in revenue in the lender-to-broker market in Q3, equaling a 17 percent year-over-year decrease from the $2.13 billion generated for lenders in Q3 2019. Year-to-date, lender-to-broker revenue has totalled $5.67 billion, a 14.7 percent decrease over the $6.65 billion generated for lenders in the first three quarters of 2019, says DataLend.

Revenue in the broker-to-broker market has totalled $1.58 billion in 2020 through the end of Q3, a 4.6 percent increase from the same time period in 2019.

The downturn in revenue for Q3 was largely driven by American and Asian equities, which declined 28 percent and 26 percent respectively, DataLend notes.

These declines were offset slightly by equities in Europe, the Middle East and Africa, where revenue increased 9.8 percent year on year in Q3, and fixed income in the Americas, where revenue increased 4.7 percent.

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Nancy Allen, the global product owner at DataLend, says: "Over the first half of this year, North American equities experienced increased fees relative to the same period in 2019 driven by a number of special names, including four of the top-five revenue-generating securities and a number of COVID-related specials.

"However, as the year progressed, short positions in US equities dropped to significant lows as markets rebounded and the S&P reached a record closing high. As a result, we saw lower fees and on-loan balances in the lending market, which drove a considerable decline in revenue."

FMDQ Clear becomes Nigeria's CCP

The Nigerian Securities and Exchange Commission (SEC) has granted FMDQ Clear, a subsidiary of the FMDQ Group, an approval-in-principle to become the country's main central counterparty (CCP).

Market observers hope the move will further undergird Nigeria's blossoming securities lending market which is still nascent but has enjoyed major growth in volumes since the CEO of the country's stock exchange promised "exponential growth" in February.

In addition, the CCP will be able to manage the consolidated risks in an operational, cost and capital-efficient manner that unlocks value for market participants within its value chain.

FMDQ says in a statement that as a critical financial market infrastructure, the achievement will redefine the landscape for financial transactions, including the development of repos, derivatives, and commodities markets in Nigeria.

The CCP adds that the approval introduces "endless possibilities to the scope of permissible products that could be developed and deployed within the ecosystem towards delivering long-lasting prosperity to the Nigerian economy".

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Commenting on the decision, Roy Zimmerhansl, practice lead at Pierpoint Financial Consulting and member of the Nigerian Stock Exchange's new Equities Product Advisory Committee, tells SLT: "This news reflects the holistic approach of Nigeria to move its capital markets forward.

"Hence the various product committees at the exchange, including derivatives and exchange-traded funds (ETF) — plus the approval for the CCP — all the components of a modern diverse capital markets infrastructure."

Zimmerhansl adds: "Securities lending is a hidden part of all of that, supporting equity market making and trading, derivatives hedging, ETF trading liquidity and revenue for lending the underlying. Potentially centrally cleared."

Elsewhere, Bola Onadele Koko, the CEO at FMDQ Group, comments: "The evolution of FMDQ Clear to a CCP marks a critical and long-awaited milestone in the Nigerian financial markets ecosystem, positioning the markets for revolutionary growth in potentially colossal proportions."

"FMDQ, as a group, is indeed appropriately placed to de-risk the Nigerian financial markets and thereby, in collaboration with market stakeholders, ensure the realisation of this enormous feat."

The change train is coming, be ready or be left behind

Securities finance market participants should aim for small but meaningful improvements to their systems and business processes as opposed to overhauling their entire infrastructure at once, according to speakers at EquiLend's Digital Transformation webinar.

The virtual event held this week brought together representatives from service providers and agent lenders, including HQLA^X, Stonewain and State Street, along with speakers from the International Securities Lending Association (ISLA) and the Risk Management Association (RMA) to discuss

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their mutual interest in embracing digitisation of securities finance markets.

Topics ranged from the success of the industry's technological answers to the Securities Financing Transactions Regulation (SFTR) through to ISLA's highly-anticipated common domain model (CDM), and much more.

Guido Stroemer, co-founder of HQLA^X and panel speaker, began by advising audience members to target incremental wins that "chip away at pain points" rather than seeking a "big bang change".

Fellow panellist Nick Delikaris, global head of algorithmic trading at State Street and co-chair of the RMA's financial technology and automation committee, furthered the point by noting that seeking budget and prioritisation internally will be easier for smaller, short-term projects, rather than to comprehensive revamp archaic IT systems.

In response, David Shone, a digital transformation consultant for ISLA, caveated that small and 'agile' changes are the way forward but they must be part of a long-term strategy.

Discussing emerging and potentially disruptive technologies, panellists warned securities lending participants against venturing too far into the still largely-uncharted waters of distributed ledger technology alone as the potential for resource drain and opportunity cost is significant.

Instead, adventurous market players should seek consensus and, where possible, collaborate in their innovation in order to bring the industry on the journey with you.

Stroemer's HQLA^X, for example, is a blockchain-powered securities lending platform backed by Clearstream's Digital Trust — an innovation centre focused on exploring opportunities in emerging technologies.

Chief among the innovations set to impact the securities finance market in the near future is the CDM.

The CDM was first launched by the International Swaps and Derivatives Association (ISDA)

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as a blueprint for how derivatives are traded and managed across the trade lifecycle. The concept is now being adapted by ISLA for securities finance transactions.

Shone, who is assisting ISLA with its CDM adaption alongside the association's new Digital Working Group, told audience members that the project will expedite the standardisation of documentation in securities finance transactions, which will, in turn, advance the push for digitisation.

While discussing the benefits of the CDM for securities financing, Armeet Sandhu, CEO of Stonewain, noted that identifying areas of the market where innovation was required was not the difficult part; the problem was gaining industry buy-in to tackle the issue en masse.

To this point, the panel's moderator Roy Zimmerhansl, practice lead at Pierpoint Financial Consulting, challenged the industry's established members to not rest on their laurels, or worse actively resist change, as "either the market can come together and create innovation or a firm will come in and do it on its own and leave some people behind".

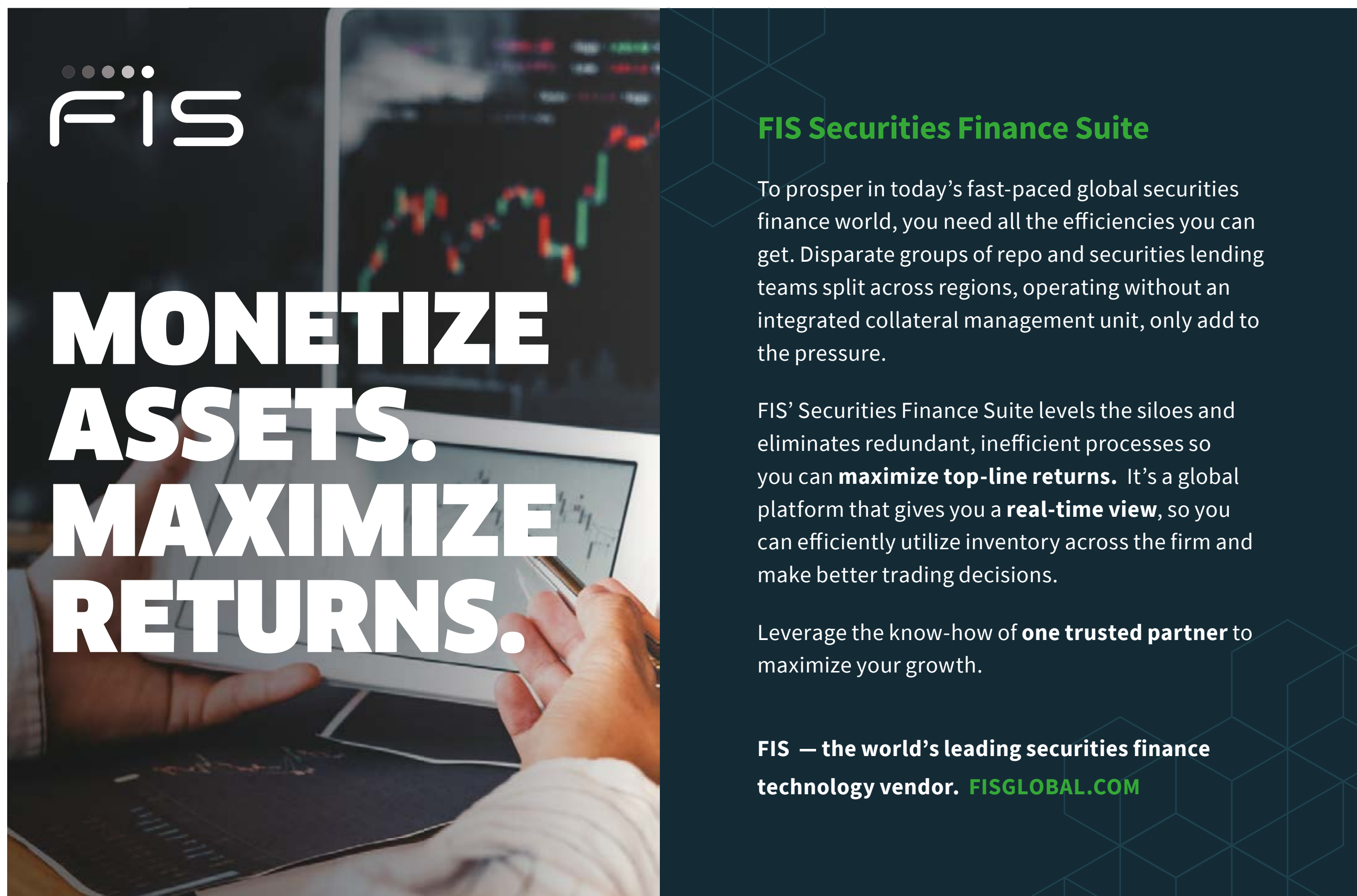
deltaconX signs up Investitionsbank des Landes Brandenburg for SFTR

deltaconX has signed German investment bank Investitionsbank des Landes Brandenburg (ILB) as the latest user of its Securities Financing Transactions Regulation (SFTR) reporting solution, ahead of phase four in January.

ILB is the second institution to be mainly responsible for the finance of a federal state of Germany.

The bank has chosen deltaconX regulatory platform to fulfil its reporting obligation under SFTR and the European Market Infrastructure Regulation (EMIR).

deltaconX offers a cloud-based multi-regulatory platform that aims to reduce the need for manual processes and high costs to achieve regulatory compliance.



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US equity lending revenue nose dived in Q3

A lack of North American equity specials during Q3 culminated in global securities lending returns declining by 28 percent year-over-year (YoY) in September, according to IHS Markit.

US equity revenues came in at $199 million, a 38 percent YoY decline but a 2.6 percent month-over-month increase. The shortfall was largely driven by the stellar returns from hot stocks last year.

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LCH SA connects to Cboe Europe for equities clearing

LCH's EquityClear service has now begun providing clearing services for Cboe Europe.

Market participants trading Euronext securities via Cboe Europe's UK order books, BXE and CXE, are now able to select LCH under the preferred central counterparty (CCP) model. This enables participants to clear through LCH if they have elected it as their CCP for Euronext securities.

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Tradeweb repo activity booms

Global repo activity through Tradeweb's electronic trading platform set a new record in September, exceeding an average daily volume (ADV) of $250 billion.

The fixed income and derivatives market platform provider says repo activity was buoyed by the addition of new dealers and participants in bilateral repo remained strong. Repo ADV was up 19.8 percent year-over-year (YoY) last month, hitting $255.8 billion.

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RMA to create digital asset adoption playbook

The first-of-its-kind digital dividend issued by Overstock.com earlier this year has revealed that the securities lending industry is not yet ready for widespread adoption of digital assets, according to the Risk Management Association in a new whitepaper.

The study represents the committee's first steps in creating a roadmap and industry playbook on how to tackle new issues.

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ESMA confirms recognition of three UK CCPs post Brexit

The EU has confirmed LCH, ICE Clear Europe, and LME Clear will be recognised as third-country central counterparties (CCPs) from January 2021.

The three UK clearinghouses will be eligible to provide services in the EU after the end of the Brexit transition period on 31 December 2020.The decision follows a call by the commission for EU market players to reduce exposure to UK CCPs by June 2022.

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Atlantic Partners Asia launches sec fin programme

Atlantic Partners Asia, a Hong Kong regulated asset manager for private equity funds, has hired Julian Smith, principal consultant of JVLD, to build its new securities finance operation as head of equity capital markets within its corporate finance division.

Smith, who is based in Sydney, says he is focusing his initial efforts on the Australian securities finance market

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Forging ahead

GLMX COO Sal Giglio offers insight into the platform's new products, senior hires and future plans for growth in a post-COVID world

GLMX has forged several new partnerships this year on everything from SFTR to repo. What is the strategy here and can we expect more alliances to come?

GLMX has built a thriving ecosystem for pre-trade, negotiation and post-trade services and our business model remains clear and focused; build technology to automate our clients' existing manual workflows. What we do every day is driven by our clients' need to become more efficient and is directed by their requirement for innovative technological solutions to complex problems. With those solutions in mind and in order to make our platform easily accessible to the wide universe of participants in the funding market, GLMX has forged valuable and productive partnerships with industry leaders.

GLMX provides a wide range of connectivity options to our clients from low tech-lift conventions such as uploading spreadsheets and file transfer protocols to comprehensive pre- and post-trade application programming interface – using industry standard and custom protocols. We also have built connectivity to eight order management system\execution management system third-party vendors that support GLMX functionality. These platforms represent some of the largest household-named OMS providers in the industry as well as several smaller but growing firms. These partnerships are important as they provide our mutual clients with immediate access to GLMX direct via their existing technology stack. We are currently integrating with several more platforms and will continue to partner with third party vendors to support growing client demand.

As market structure in securities finance continues to evolve and as participants develop new tools in response, GLMX reacts quickly to support these changing behaviors. Some of these market structure changes demand tools to help control capital costs via dynamic balance sheet management such as 'sponsored' repo while other changes respond to regulatory reporting requirements like the Securities Financing Transactions Regulation (SFTR). In support of this important netting activity, GLMX has established relationships, both in the US and UK/Europe with market-leading clearinghouses to report cleared transactions and to explore comprehensive solutions for our clients. To further support our clients' reporting requirements under SFTR, we have established relationships with major designated trade repositories.

Interconnectivity is a core tenet of the financial markets and GLMX believes partnerships are a key component of a successful business.

You have also significantly bolstered your bench with new senior hires this year as part of a reshuffle to reflect GLMX's growth. How is everyone settling in?

As a financial technology company, we constantly seek the right balance between financial markets experience and technology acumen. In both respects, it is essential to add talented individuals who can adapt quickly to a constantly changing financial and digital marketplace.

We believe our recent management restructure and new senior hires puts the company in a perfect position to deliver uninterrupted, innovative, customised and creative solutions for our growing client base.

Our two most recent senior hires are examples of the high bar set at GLMX.

Andy Turvey, director of sales for Europe, the Middle East and Africa (EMEA), and former head of EMEA securities financing sales for J.P. Morgan not only brings almost 20 years of repo experience and deep buy-side relationships, he also has been a vocal advocate of the digital transformation in the securities financing market. For several years before joining GLMX, Andy envisioned the virtues of electronic repo trading and enthusiastically communicated that notion with his clients and colleagues. The fruits of his ongoing efforts are reflected in the deep pipeline of new clients he has and continues to build for GLMX.

Kyle O'Donnell, chief information officer, is a veteran of fintech startups. Formerly of Symbiont.io and TrueEx, Kyle is well versed in building enterprise infrastructure and data security that can scale with a fast-growing company like GLMX. While fortifying our infrastructure, Kyle has also implemented new technology to make the remote working model more efficient and secure.

As we continue to strengthen the GLMX management team, we

anticipate adding one more senior hire to support our growth before the end of the year.

In addition to adding skilled leaders, we have taken a global approach to our client business as it better aligns GLMX structure with that of its clients, which engage their diverse counterparties across all currencies and asset types. This approach gives us a holistic view into our clients' needs across all regions which empowers us to identify best solutions and prioritises development of those solutions

.

We are on the verge of SFTR phase three. The first two phases went pretty smoothly, but this time it's the buy side. Do you foresee difficulties?

We believe the transition, technology-aided as it is increasingly, will continue to be relatively smooth. Many technical teething problems were dealt with in the earlier phases. That said, we at GLMX feel the incremental challenges will revolve around pairing and matching. As the buy-side comes into play, a much broader range of firms will begin to report. The flows of these firms are less homogenous compared with the firms already reporting and matching. Our expectation is that any difficulties encountered with matching will further accelerate the drive to digitise the trade and lifecycle negotiation process so key details are agreed and shared at the point of negotiation.

At GLMX, we've seen rapid adoption of our technology over the past six months as buy side firms looked to ensure their processes are ready for the new reporting regime in addition to the sell side wanting to streamline their trading and reporting flow. We expect this trend to accelerate as firms look to optimise their trade execution and reduce operational friction associated with breaks in the matching process. The trend towards electronification for SFTs has been growing organically over the past few years – SFTR and COVID have turbocharged that march to a digital future.

Earlier in the year you teased us that you had a busy pipeline of innovations to come. Can you give us any more detail now?

One of the many exciting things about working at a leading-edge technology company, is that our clients work with us to develop new functionality, protocols and trading options. Our engineering team has continued to develop new features and functionality, commensurate with our clients' needs, and our integration team continues to be busy on-boarding new clients.

> *The trend towards electronification for SFTs has been growing organically over the past few years – SFTR and COVID have turbocharged that march to a digital future*

We are excited that as clients have become more comfortable with the current working situation, they have engaged GLMX to work on truly innovative projects that will be completed in 2021. Stay tuned.

GLMX has expanded its presence in the US and the UK. Can we expect further growth this year?

We will continue to expand our footprint in the US and the UK/EU in line with the growth of our client base. Working remotely, whether that

be from home or elsewhere, has increased the need for streamlined, efficient and risk-mitigating workflows. Electronic trading platforms such as GLMX provide exactly those types of solutions and thus, clients already in our pipeline plus numerous new clients have hastened the onboarding of our technology since the pandemic took hold earlier this year.

Our average daily volume has roughly tripled compared with this time last year. By the end of 2020, we expect to have twice as many dealers on the platform as we did at the end of 2019 and we have seen both a significant increase in buy-side users and a diversification in buy-side type as well. Although hedge funds and asset managers were early adopters of our technology, we are encouraged that sovereign wealth funds, insurance companies, money market funds and agent securities lenders are now moving forward with GLMX.

As evidenced by our recent senior hires as well as new additions to our client onboarding, infrastructure, and development teams, and our business realignment, we anticipate and are well prepared for continued growth in the US and UK/EU.

One of the main lessons from the COVID-19 pandemic is the vital importance of automation. Will the securities finance industry gain a renewed emphasis on pursuing automation and digitisation?

The year 2020 will be remembered for a lot of things, some existential and others theatrical, but it also will mark the moment when the largely manual workflow supporting repo trading officially flipped to digital. External events and regulation often are the catalysts which inspire innovation and drive market-wide adoption of new technology. The virtually overnight move to remote work in response to the pandemic and the need to digitise trade reporting for SFTR provided significant tailwinds for digitisation and automation in the securities financing markets.

The proverbial horse is out of the barn when it comes to the market's advocacy of the long-needed efficiencies provided by electronic repo trading platforms. This is evident in the adoption rate of both the sell-side and buy-side. Leading dealers already are using technology to digitise trade negotiation, automate trade processing and to support the growing demand of their large buy-side clients. In turn, as the dealers reap the benefits of electronic trading and build tools to better access trading platforms, they are encouraging more of their buy-side clients to onboard GLMX. With remote work likely to extend well into 2021, this network effect will continue to be a key driver of GLMX's progress.

Digital strategy takes many forms. Whether being an early adopter of low touch, fully-automated trading or accommodating trading partner requests for improved efficiency and risk management, participants increasingly need to support some form of automation. The level of complexity varies by participant but one thing is certain - If not currently working with a digital strategy, you are behind.

And, finally, while the efficiencies of digitised SFT trading flows provide significant value as a stand-alone, the increased access to liquidity which attends this electronic transition cannot be overstated.

Sal Giglio
COO
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THE NEW NORMAL

DIGITAL ASSET CORPORATE ACTIONS

RMA Financial Technology and Automation Committee

Considering Overstock.com's recent digital stock dividend and its implications for securities lending

Digital assets and distributed ledger technologies (DLT) are among the developments challenging the financial services industry's status quo. As the cloud of novelty and mysticism around the technology dissipates, it is clear that innovation has the potential to transform from end-to-end across market participants and even how the industry operates. Securities lending participants must ensure an infrastructure that is prepared for emerging technologies such as digital assets. digital asset dividends. corporate actions, and DLT alternative trading systems.

To examine, inform, and facilitate an industry approach for adopting these new technologies, RMA's Financial Technology and Automation Committee commissioned this white paper and an industry survey to study and begin formulating a roadmap. This case study illustrates and benchmarks the industry's current position and readiness for digital assets, while providing insight on the reactions by market participants with respect to Overstock.com's recent digital dividend.

Background

On 19 May, Overstock.com completed the first issuance of its Digital Voting Series A-1 Preferred Stock "Series A-1" (OSTKO), a digital dividend championing the use of digital assets. This digital issuance was the first of its kind.[i]

Considering the resulting actions by securities lending market participants, the approach to handling this type of issuance may need to evolve and become more deliberate. Orchestrating a one-off mini-close-out, restricting lending, selling off entire positions, and opening accounts at the tZERO alternative trading system (ATS) worked as stopgaps, but the industry must come together to provide a strategic and consistent solution for the future.

In reflection, the securities lending industry was able to weather this event by overcommunicating with market participants and hand holding during the transaction lifecycle. This ultimately curtailed a lot of activity. But what if several large cap blue chips issue a digital asset dividend simultaneously, and decide to institute seek licences for their own alternative trading system?

Currently, the industry could not replicate its Overstock.com response. What does the industry need to do to enable a better operational model? This line of questioning and thought-provoking discussion is exactly what Overstock.com CEO Jonathan Johnson and chairwoman Allison Abraham wanted.

They noted:

"The goal is that as regulators and market participants become increasingly comfortable with DLT/blockchain technology it will gradually play a larger role in the overall process to the benefit of investors, regulators and other market participants... the successful issuance of dividend will demonstrate to other issuers and market participants that this technology is scalable and has significant benefits to all market participants."[ii]

Market participants must learn from this corporate action and prepare to adapt for the possibility of others.

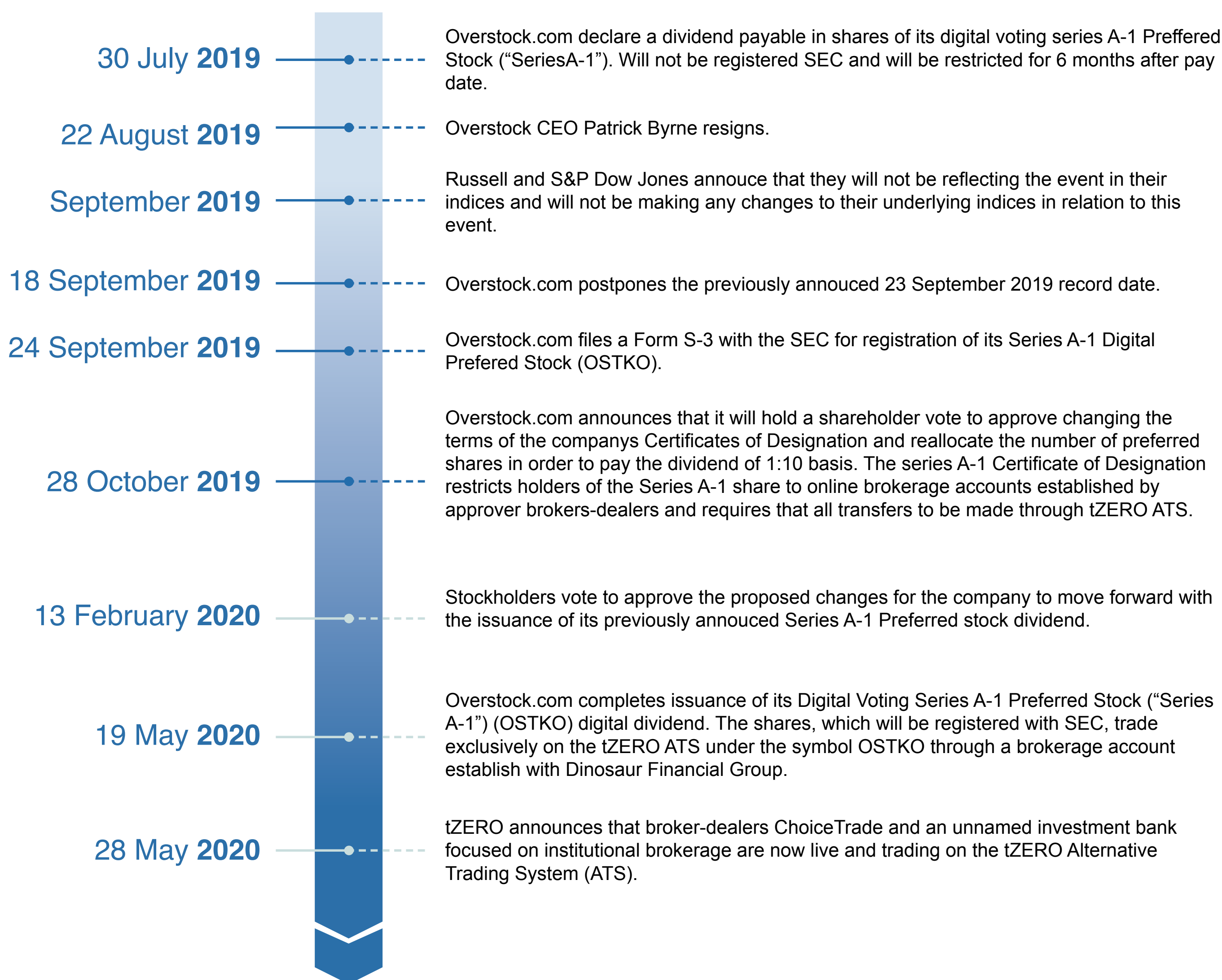
Background and barriers to entry for digital assets

In late 2017, as a result of the growing value of cryptocurrencies, interest in digital assets within the traditional asset lending space was high. It was realised that digital assets have "the potential not only to add new asset types but to make existing processes more efficient and to create entirely new roles as well as adding new techniques such as smart contracts."[iii]

Fast-forward to April 2020. Despite this interest, security tokens were traded on only two exchanges—OpenFinance and tZERO—and with limited liquidity. These activity levels can be attributed to:

1. Regulatory barriers to entry
A company seeking to launch an ATS to issue a security token requires a regulator (such as the SEC) to approve a licence. This is a slow and expensive process with no guaranteed return on investment.[iv]

2. Investor interest
Although there is neither a universal consensus nor the data to evidence the long-term benefits of financial services DLT-based infrastructure, the individual and industry benefits from use cases- and instances where such DLT solutions have been deployed-are known. In the case of tokenised/crypto assets, benefits include instant settlement cycles via smart contract and the reduction in fails and back office exceptions arising from reconciliation. As market participants become increasingly comfortable with DLT, the quantifiable and qualitative benefits will become clearer. Whether those benefits will be realised from the start or only gained after reaching critical mass remains to be seen. It could be argued that DLT will only add another channel and data standard that would have to be rationalised among the disparate current-state infrastructure.



Overstock.com navigated through regulatory obstacles and barriers, although not unscathed, to issue a non-native asset. It is important to note that the main success of this milestone could be that Overstock.com owns the ATS, tZERO. tZERO issued the digital token against Overstock.com' s common stock at a 1:10 ratio. Some market participants have seen Overstock.com's digital dividend in a different light, calling the corporate action transaction processing more cumbersome and less efficient.[v]

What is the impact of this disruptive event?

As is often the case with disruptive events, the issues that may arise must be considered.

On this note, the RMA's Financial Technology and Automation Committee surveyed leading market participants to better understand just how disruptive this event has been for the securities lending industry.

In light of the committee's objective to examine, inform, synthesise, and facilitate an approach to adopt new technologies as an industry-and utilising Overstock.com's digital dividend as a case study—the committee polled the securities lending industry. The findings are summarised below:

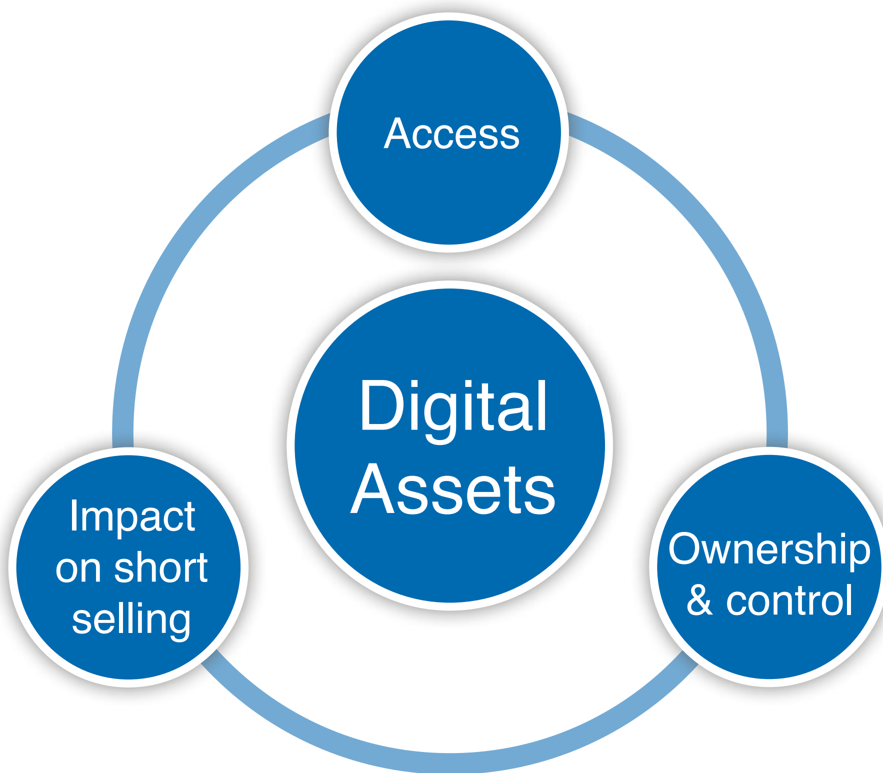
- The survey was sent to 39 market participants including agent lenders and borrowers. Thirty-one responded.
- Fifty-four percent of agent lenders who owned Overstock.com shares decided to recall outstanding loans and restrict lending over record date.

In most cases this course of action was driven by concern over the operational processing of such a distribution far exceeding its inherent value.

- Forty-six percent of lenders who owned Overstock.com shares decided to continue lending over record date. Eighty-two percent of these lenders received cash in lieu payments. No respondents said they received digital assets as a manufactured dividend. While the processing of these cash in lieu payments was deemed straightforward, there were challenges regarding the valuation of the digital asset, legal terms, and client communication.

- Eighty percent of borrowers did not borrow over record date. This was driven by two main reasons. Half the respondents mentioned this was an internal decision nor to be exposed to this distribution. The other half saw their shorts covered prior to record date.

In synthesising thematic issues, areas of most concern to market participants can be categorised as follows:



Access

Publicly traded shares normally are freely tradable across exchanges. Broker-dealers have their established network, piping, routers, and dealers to achieve best execution. However, that status quo is being disrupted because of a condition of the OSTKO digital dividend: The holders must trade the asset exclusively on the tZERO ATS. GTS CEO Ari Rubenstein personified the feeling of much of Wall Street when he said, “America’s market system is not based on dictating the trading venue and charging exorbitant fees.”[vi]

Limiting trading to one venue (with a limited number of broker-dealers as of this writing) may prompt fair criticism chat making the sale of such securities difficult and expensive is to the detriment of investors. However, regulators may see chis as a longer-term play, franchising investors and purposefully allowing cZero and Overstock to be a “positive disruptor”.[Vii]

Maybe tZERO and Overstock’ s digital play is seen as contributing to competitive pricing and discouraging unfair practices. Though, if the latter is true, others will follow, potentially forcing broker-dealers to subscribe to a number of actions-one being subscription to new ATSs. Alternatively, will broker-dealers be compelled to disclose chat they cannot trade certain securities chat pose a risk to their margin and reputation?’[viii]

Impact on short selling

During his tenure, former Overstock.com CEO Patrick Byrne openly combatted short sellers. Intentional or not, the digital asset distribution triggered short covers chat coincided with a very steep rally days before the initial record date of September 2019, thereby pointing towards a short squeeze.[ix]

The theory behind a squeeze comes down to the obligation a short seller faces to pass dividends back to the lender of the shares. Back in September 2019, there were many unanswered questions on how to pass on a digital dividend, which in turn triggered several market partici-

pants to take actions to reduce risks related to this distribution including lenders recalling shares out on loan ahead of record date.

When the distribution eventually took place in May 2020, market participants took different approaches to handle this event. Some agreed to receive an equivalent value in cash of the digital dividend. Others decided not to lend OSTK over record dace, thereby reducing the liquidity available in that name.

> *The industry must come together considering that digital assets may be the new normal, and decide how best to prepare. Understanding how to influence change at your organisation and discussing solutions is a starting point*

Ownership of stock

A well-known benefit of using DLT solutions is the inherent "chain" of ownership, transactions, and transparency. Today, while the custodial market share may be owned by a few of the world's largest custodians, the market is still saturated with many other custodians and transfer agents. They have different systems, standards, and channels, resulting in ambiguity with respect to security ownership. That is amplified in securities lending when securities are lent, sold, and substituted. The Dole Food buyout, where 49,164,415 shares were claimed when only 36,793,758 shares were outstanding, is an example. The resulting disputes regarding shareholder ownership resulted in a $115,700,000 settlement.[x]

This case reveals the existing infrastructure around ownership is outdated, creating risk for both brokers and shareholders alike. A distributed ledger provides an effective real-time track record of ownership. making it easy to attribute relevant entitlements such as dividend payments. In the case of Dole Food relevant short sellers could have been easily identified—saving significant time and expense (though the issue of enforcing payment would still be a problem).

What now?

The industry must come together considering that digital assets may be the new normal, and decide how best to prepare. Understanding how to influence change at your organisation and discussing solutions is a starting point. Organisations must build a perspective on how it affects securities finance and how to align themselves accordingly. RMA's Financial Technology and Automation Committee is seizing this as an opportunity to not only solve an industry issue of processing digital dividends, but also co consider creating an industry playbook on how to tackle other new issues uf first impression as they inevitably occur in this ever-disruptive industry.

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REG WARS: A NEW HOPE

Drew Nicol reports

The European Commission's newly-outlined action plan for the coming years of regulatory initiatives has given securities finance market participants fresh optimism that some of today's most stubborn regulatory headaches may soon be soothed

The European Commission (EC) has offered securities finance market participants a glimmer of hope that some of their biggest regulatory bug-bears may soon be addressed as part of its action plan for developing the Capital Markets Union (CMU).

The CMU is arguably one of the EU's most ambitious projects and aims to unify member states through standardising financial markets from top to bottom.

The EC adopted the first CMU action plan in 2015 and the latest iteration, published in late September, argues that "significant progress" has been made "on putting the building blocks in place". However, the report notes that "a lot still remains to be done and it is now time to step up the level of ambition".

To that end, the commission has now detailed its next set of key priorities and legislative initiatives on capital markets to be completed by 2023.

The scope of the CMU is vast, but the latest action plan touches upon some very specific sore points for securities finance markets, namely the Central Securities Depositories Regulation (CSDR) and the Shareholders Rights Directive (SRD), which was updated to its second form on 3 September.

CSDR

Since the 2007/8 financial crisis, regulatory oversight has developed such that a constellation of new acronyms — each representing a plethora of new rules — now hangs over the securities financing landscape.

The one in accession directly over our market is the Securities Financing Transactions Regulation, which went live in July and required market players to construct comprehensive new technology frameworks to submit an offering of transaction data hitherto inaccessible for market overseers. What they will do with this hoard of information is yet to be seen.

But, the four letters keeping market participants up at night the most is CSDR. In brief, this regulation aims to create a common set of prudential, organisational, and business standards for EU CSDs.

A key aspect of CSDR is the settlement discipline regime, which is designed to support the Target2-Securities initiative by introducing mandatory buy-ins and cash penalties to encourage participants to improve settlement rates.

The regime has been plagued with issues — including a persistent lobbying effort by industry bodies flagging the potentially catastrophic consequences of its introduction — which have culminated in a second 12-month delay meaning it will now not see the light of day before February 2022, if at all.

As part of the EU's action plan, the commission is committed to a review of the regulation aimed at improving cross-border settlement services. However, the investigation, which will not be completed before Q4 2021, will only focus on the CSD passport (its licence to offer services across the EU) and conditions for CSDs and credit institutions to provide bank-like ancillary activities. The settlement discipline regime, however, will not be examined.

Part of the reason behind this is that the review is not a direct reaction to stakeholder concerns but is required as standard for all EU regulation five years after implementation. Market observers described being disappointed, but not surprised.

That said, all is not lost. Before this review can take place, the commission must conduct a consultation with industry stakeholders and the European Securities and Markets Authority (ESMA). The scope of this consultation was recently expanded to include a discussion on all aspects of CSDR, including the regime.

This opens the door to the most outspoken reform advocates, such as the International Capital Market Association (ICMA) and the Association for Financial Markets in Europe, to repeat their concerns once again and, they hope, begin a dialogue for meaningful change that pleases all parties.

The outreach effort was meant to take place last year but was bumped due to the hectic regulatory schedule. It is now expected to take place before the end of the year.

The commission will be under no illusion as to the feedback it will receive. In its letter to ESMA recommending the delay to 2022, it stated: "Other stakeholders have also noted that market developments during this crisis would have been significantly worse in terms of available market liquidity (especially in the non-cleared bond and repo markets) if the mandatory buy-in regime was in place. We note that certain stakeholders have been precise in their communications to us, asking that the entry into force of the regulatory technical standards on settlement discipline be postponed for an additional year."

This is a direct reference to one of the central concerns raised in ICMA's latest of several letters sent to EU rulemakers on the subject of CSDR's flaws. To address market issues with the mandatory buy-ins would require the commission to re-open the level one text and rebuild from the ground up. It has so far preferred to kick the can down the road but sources close to the matter are quietly confident that regulators now accept the rules are potentially damaging to market stability and are willing to give ground. Whether that means the buy-in rules are scrapped, which is the preference of many in the market, or just amended is yet to be seen.

SRD II

SRD II will require asset managers to disclose their policy on securities lending to institutional investors and how it is applied to fulfil its engagement activities, particularly ahead of the general meeting of the investee company. Among SRD II's primary aims is to crack down on the misuse of voting rights, which were previously abused in several ways including via the borrowing of shares ahead of key corporate action dates to influence the result of company votes.

Similar to CSDR, those in-scope for SRD II were ringing loud alarm bells on its several defects long before it came into effect in September. Chief among these shortcomings is the fact it's a directive and not a regulation, meaning it must be interpreted by each of the 27 EU member states. This is particularly pertinent to the defining of key terms, such as 'shareholder'.

Unsurprisingly, in the immediate aftermath of go-live, market commentators highlighted that 27 slightly different definitions of a stakeholder now existed across the bloc.

To address this directly, the CMU action plan references the "possibility of introducing an EU-wide definition of shareholder". The catch is that this was originally earmarked for completion by June 2022 but thanks to the pandemic disruption a legislative proposal to this effect may not appear until Q3 2023.

In addition, the EU also wishes to clarify rules on the corporate actions process, and the analysis of potential national regulatory barriers to the use of technology to facilitate communication between issuers and shareholders that will be taken forward by Q4 2021. Market sources described the plan as "promising" but were unwilling to celebrate until proof of the EU's commitment to the task was clear.

Despite the tepid wording, the EC's acknowledgement of the specific issue of defining a shareholder is a step forward from earlier this year, when 11 trade bodies including the International Securities Lending Association, the European Banking Federation, ICMA, and AFME unsuccessfully pushed for a one-year delay to SRD II implementation. In its response to the joint letter in June, the commission made no reference to the shareholder problem while also dismissing the group's claims that the pandemic had scuppered their implementation timelines.

In the days before implementation, the same group reiterated their concerns in a new letter and requested confirmation that, given the several areas of ambiguity in the rules framework, no fines for non-compliance would be issued until September 2021. They are yet to receive a response.

A NEW COLLATERALISED WORLD

Chris Walsh, CEO of AcadiaSoft, sits down with SLT to discuss the impact of COVID-19 on collateral management by accelerating automation, and explain the new concept of deep straight-through processing

Natalie Turner reports

How has COVID-19 affected the industry?

In the short-term, the primary impacts we've seen at AcadiaSoft are increased market volatility, volume spikes and forced virtualisation. Firms have had to develop crisis response plans and operate at a faster pace to meet client needs, which are rapidly evolving in this environment. Many of the changes made to improve operational efficiency that were catapulted forward during the pandemic may very well become permanent.

How has AcadiaSoft managed during this difficult time?

AcadiaSoft was created and structured to protect market participants, especially during times of crisis or challenge. We have been able to maintain and, in some instances, exceed productivity levels beyond where they were prior to the pandemic. We were able to seamlessly scale up to meet demand as margin call automation rates increased by nearly 80 percent during March. Most notably, despite the increased volume, there was no increase in call dispute rates.

Is it important for organisations to transform their front-to-back collateral management infrastructure and processes that were exposed during the COVID-19 pandemic?

COVID-19 exposed manual methods that are difficult to perform remotely, and accordingly accelerated the adoption of increased automation and standardisation within the margin call process. While this occurred out of necessity, we believe the industry will continue making progress and reap the benefits of this increased efficiency. For example, we have over 200 organisations automating their interest statements and we expect to see full automation across the AcadiaSoft community very soon. This will eliminate email exchanges and lengthy disputes from the production of final interest statements between parties and further streamline the margin management process.

Whilst automation and standardisation are a large part of the transformation, there is also an increased need to focus on exceptions-only processes. Identifying and fixing disputes early in the workflow assists teams to become nimbler enabling them to eliminate costly errors or settlement fails.

Why must collateral management adapt in order to meet the challenges of a post-COVID-19 world?

Collateral management was evolving rapidly prior to the pandemic. Collateral management was already becoming more standardised and automated, and the pandemic has fast-tracked this. Now, firms will need to make significant changes in order to remain competitive. Business processes and procedures will be re-evaluated. Project initiatives will become more streamlined. Ultimately, this standardisation and automation will allow firms to operate faster, more efficiently and with less risk, regardless if the future is back in the office or in a remote environment.

What are the transformation opportunities for collateral management?

The industry has a prime opportunity to transform the collateral management workflow. AcadiaSoft is doing its part by automating processes, simplifying Uncleared Margin Rules (UMR) implementation and providing new tools for clients. Specifically, our Relay service, which enables streaming email, spreadsheet and PDF exchange of margin calls into a firm's existing margin workflow, now represents more than 560 firms and has expanded our community to more than 1,400 organisations – growing at 500 channels every quarter. Additionally, our repo volume has seen record growth of 80 percent over the past year as firms look to automate entire over-the-counter inventories.

How are technology and data influencing the future of collateral management?

I believe data is going to propel the industry into the next phase of collateral management. Earlier this year, AcadiaSoft launched its Data Exploration Suite, which allows clients access to data pulled from every aspect of its services and partner services. Firms can now review data and analytics, from industry and peer group comparisons, to periodic and real time dispute monitoring and volume trend analysis. The more data is available, the more firms can optimise operations and risk management. More data will also lead to increased and smarter automation, helping collateral management move smoothly, and eventually, result in a 'no-touch' process.

What can we expect for the future in collateral management?

We see collateral management on the path towards risk prevention, meaning that the majority of current issues will be resolved before they happen. Electronic margining has been gradually transforming the industry and we're nearing the point where all calls are electronic, at which point we'll be ready for a whole new level of automation.

The next level we want to achieve is 'deep straight-through processing (D-STP)'. Similar to an in-depth learning system that digs deep into data to draw conclusions – the workflow systems will dig deep to determine whether a call exception needs to be reviewed and who needs to analyse it. We believe that widespread electronic messaging, coupled with D-STP, has the potential to revolutionise collateral management for the better.

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Green is the new black

Members of ISLA's ESG working group and Council for Sustainable Finance describe how responsible investing has taken centre stage in the global economic fightback against COVID-19

Panellists

Matthew Chessum, investment director, liquidity management, **Aberdeen Standard Investments**
Andrew Dyson, CEO, **ISLA**
Stefan Kaiser managing director, EMEA/APAC securities lending product strategy, **BlackRock**
Chirag Patel, executive director, EMEA head of cross asset financing, **Goldman Sachs**

Given that ESG is a broad topic, what has the ISLA ESG working group been focusing on in 2020?

Andrew Dyson: During a year that has been dominated by the COVID-19 pandemic, we did see some of the core regulatory and policy initiatives coming out of the European Union pause, particularly during the first peak of the virus across Europe. After identifying the green agenda as a major priority, incoming European Commission President, Ursula von der Leyen promised in April to put the European Green Deal at the centre of the EU's post-COVID recovery plan. These comments are important as they clearly link a post-COVID world to the developing green agenda, and this broad direction of travel will shape much of our thinking going forward.

In the middle of the year, we saw a detailed consultation from the European Commission on the Renewed Sustainable Finance Strategy. In this, the commission sought the views of how markets and trading eco-systems need to evolve to support the sustainable finance objectives across the EU 27.

In responding to this consultation, our environmental, social and governance (ESG) working group highlighted the importance of supporting the growth of ESG funds in the context of trading liquidity, price discovery and effective settlement. In this regard, the group stressed the importance of mobilising ESG securities within lending programmes to support the development of a broadly-based market ecosystem. The final key message that we delivered through our response to the consultation was that it was important not to create separate trading infrastructures for ESG securities, but rather regulators and other stakeholders need to work to incorporate more ESG securities into existing trading frameworks.

Stefan Kaiser: The initial focus was on responding to the EU consultation on sustainable finance. This consultation provided an opportunity to comment on how regulation around ESG might impact securities lending and highlight how the activity can contribute to achieving long-term policy goals. As investors' focus on ESG increases, we need to explain why securities lending and sustainability are not in conflict and how the benefits that securities lending delivers can be preserved in an ESG framework.

Chirag Patel: The ISLA ESG working group has spent time this year on the European Commission's consultation on Renewed Sustainable Finance Strategy focussing upon how the securities finance market can adopt and embrace ESG principles more seamlessly. Considerations include but are not limited to (i) the impact of ESG principles to various market participants (ii) incentivising broader market engagement/ participation; and (iii) suggestions to the relevant regulatory bodies, in all cases taking into consideration the policies, rules and laws already in place. Key challenges include (i) infrastructure; and (ii) alignment across regions/financial markets which could act as a catalyst for further standardisation of ESG principles across the industry (e.g.

long termism, sustainable investment, availability of data/benchmarks, corporate governance, etc).

ESG principles and securities lending can sometimes be portrayed as incompatible. Do you see this preconception disappearing, as responsible investment strategies become a clearer focus for the EU?

Matthew Chessum: A drive for strong governance and responsible stewardship has always been present within the securities lending industry. Voting requirements, recall management, programme transparency, tax and short selling have all been discussed at length in the past and have all been actively managed to ensure that best practice and strong governance guidelines are followed. ESG is neither new to securities lending or more importantly incompatible. Any preconceptions in regards to this are disappearing fast. As the importance of ESG investing continues to permeate all financial markets, the securities lending industry is well-placed to build upon existing best practices by both embracing and developing the Principles for Sustainable Securities Lending (PSSL) that were issued by the ISLA Council for Sustainable Finance in February. This will allow the industry to become an important leader in market led governance within this area.

Kaiser: The growth of ESG has raised the question of compatibility, but the focus on investment stewardship or the 'governance' component of ESG and short selling aren't new. We firmly believe that short selling is a crucial contributor to efficient capital markets and that lending securities is not in conflict with effective engagement with companies. Earlier this year, we wrote a paper on securities lending and sustainability, based on the feedback we received, most ESG focused investors are not asking 'if' but instead 'how' securities lending should be conducted within their portfolios.

Dyson: There is no doubt that certain elements of the ESG agenda can create what looks like a natural tension with the broad objectives of a securities lending programme. However, we firmly believe with the right amount of rigour around how institutional investors organise their programmes, and with due consideration of best practice frameworks such as the PSSL, the two may quite happily co-exist. Securities lending programmes that have been calibrated to reflect the client's ESG principles can achieve those twin objectives. For example, if a client has a clear and communicated strategy around voting, this can be implemented by their lending agent or partner, with securities being recalled for desired votes and other official record points, etc.

Patel: I think that the two can indeed be compatible however it will be reliant upon progress being made on infrastructure, the appropriate incentive structures and alignment at a (inter)national level and an improvement in the quality/uniformity of data available to market participants. The view from the working group was that investors do not need to sacrifice returns through responsible investing and with further guidance/policy steps from the EU investors should gain confidence in being able to make rational/responsible decisions in

Andrew Dyson
CEO
ISLA

By supporting short selling, institutional investors are facilitating deeper and more transparent markets which are entirely compatible with any longer term aspirations they may have

Matthew Chessum
Investment director
liquidity management
Aberdeen Standard Investments

A drive for strong governance and responsible stewardship has always been present within the securities lending industry

securities lending; a very recent example is the update to the Japan Stewardship Code earlier this year to factor in ESG concepts. Securities lending is essential to ensure liquidity/transparency, smooth functioning of capitals and revenue generation.

Some industry participants argue that the practice of short selling is not only consistent with long-term ESG investment strategies, but that the promotion of short selling is the best thing for a fair market. Do you agree?

Dyson: Short selling is now a part of the fabric around how markets function efficiently. It is a highly-regulated market with specific rules that require borrowers in most jurisdictions to identify a 'borrow' to cover a short position. During the recent market turmoil around COVID-19, whilst we did see some temporary bans on short selling, their implementation received a mixed reception from market participants and some regulators, many commentators feel that short selling is simply a way of expressing sentiment and is no different from going over or underweight an index. By supporting short selling, institutional investors are facilitating deeper and more transparent markets which are entirely compatible with any longer term aspirations they may have.

Kaiser: Securities lending is a well-regulated practice that contributes to capital market efficiency and also enables end-investors to generate additional returns on their investments. Market efficiency is a tangible benefit for end investors: the added liquidity supports the price discovery process. It can help prevent pricing bubbles from occurring and contribute to reducing trading spreads that in turn can bring down trading costs for investors.

Chessum: Short selling has always been an emotional topic with strong opinions on both sides of the argument. Recently, with the demise of Wirecard AG, we have witnessed first hand the fiduciary role that short selling can play in the market. Short selling is a market tool like any other. Selling an asset has no greater influence on the price than buying the same asset and fair pricing is reliant upon investors being able to express their views on individual stocks. There should be a clear distinction made between covered and uncovered short selling. Covered short selling does not artificially add to the free float and therefore does not have an exaggerated effect on pricing. I believe that the value that short selling brings to the market is better understood now than during any other point in history. Despite this, it does appear to be a convenient scapegoat during times of market dislocation and downward trends. Only recently, during the COVID sell off, some blamed short selling for the falling markets when the most plausible reason was that investors were liquidating assets in long only funds and starting to hoard cash.

Patel: Short selling with the appropriate governance at all levels should allow for a fair market to efficiently function, which in turn helps to give confidence to investors and other participants as to the true market depth, liquidity, access and price of an asset. Creating price transparency/efficiency in a fair market can therefore be

consistent with long term ESG strategy. Short selling can also allow investors to hedge their ESG risk by influencing companies who fall short of their social responsibility expectations, e.g. potentially due to poor management, corruption, environmental impact, etc. Activist investors are one key party in ensuring these companies remain accountable, however there will need to be controls in place to allow such companies a chance to improve their compliance without impairing their efforts.

The activities of short sellers have dominated the headlines this year. Do these types of borrowers have a part to play in creating a sophisticated ESG-focused world?

Chessum: The recent ICSF published Principles for Sustainable Securities Lending includes covered short selling. This principle, unsurprisingly, generated a lot of debate within the council executive but the decision to make a firm commitment to the importance of covered short selling to financial markets was unanimous. The council recognises the role that short sellers can play in discovering important issues within certain companies. Short selling is likely to be employed further in the future to promote good corporate governance. Some long only managers may not only invest in those companies that are perceived to have strong ESG credentials but venture into short selling those that are considered to not be meeting their ESG obligations. Surely, this would represent the true spectrum of companies in relation to their ESG credentials.

Patel: Short sellers play a pivotal role in the securities lending market in an ESG-focused world and therefore aid general market dynamics with respect to the supply and demand of collateral; as specific ESG assets trade richly, short sellers help to create price efficiency in the market. Investors for example may have a positive impact in an ESG-focused world through exerting pressure on companies with poor ESG ratings to change their strategy at a senior level to be more compliant, i.e. incentivisation.

Dyson: As part of the developing ESG landscape, short sellers have an increasingly important role that they can play in providing scrutiny, and holding companies accountable for their ESG actions. 2020 has seen how the scrutiny afforded by the hedge fund community has bought issues into the spotlight that have previously been kept from public view. In this regard, short sellers are able to highlight those companies that are not adhering to their ESG deliverables. By highlighting so-called green washing, hedge funds bring very real accountability perhaps not seen elsewhere throughout the investment process.

Kaiser: There is plenty of empirical evidence available showing that short selling and price discovery are integral to well-functioning financial markets. Being able to express positive and negative views on a security are key in preventing pricing bubbles from occurring. In addition, a ban on short selling is shown to increase trading spreads that, in the end, investors pay for.

Stefan Kaiser, managing director EMEA/APAC securities lending product strategy, BlackRock

Being able to express positive and negative views on a security are key in preventing pricing bubbles from occurring

Chirag Patel
executive director
EMEA head of cross asset financing,
Goldman Sachs

Investors may have a positive impact in an ESG-focused world through exerting pressure on companies with poor ESG ratings to change their strategy at a senior level

Over time, stock prices react to fundamentals and are not driven by short selling. Investors who participate in securities lending can benefit from lending revenues when there are questions about a company's valuation and independently of that, from stock price increases when the fundamentals of a company improve. Securities lending and short selling are therefore consistent with the interest of long-term investors.

Part of the challenge with incorporating ESG into the securities lending world, is the lack of any uniformity in what is considered a highly rated ESG security. The ICSF is working to rectify this through its principles for sustainable finance. How is the Council progressing and what could its widespread adoption mean for the market?

Chessum: The ICSF has now established a set of principles that can be adopted by the market and incorporated into any securities lending policy. These principles were devised by a group of beneficial owners and published by ICSF to provide the market with some initial guidance on what needs to be thought about when devising ESG policies in relation to securities lending. As the ESG conversation evolves, so will the principles. A second version is already being looked at which will have additional principles attached which will cover important topics such as diversity and inclusion. Widespread adoption of these principles will lead to better governance and more aligned best practise. Whilst this list is not exhaustive, it does provide a sound starting point for any organisation looking to develop their internal policies.

ICSF understands that the principles that the market adheres to need to be accepted and agreed to by all market participants. This is why we are very pleased with the raft of new partnerships that have been made with the most sophisticated and prominent agent lenders and securities lending associations.

I would encourage beneficial owners in particular to consider full membership of the council given the focus on asset owners to incorporate ESG into the investment decisions. Going forward the council will be producing technical guidance on the principles and is expected to be a one stop shop for everything related to ESG and securities lending.

Dyson: 2020 has been a year when we have seen considerable interest in the work of the ICSF, with many firms from across our industry aligning themselves to both ICSF and the PSSL.

The PSSL have identified a number of key areas where the market needs to develop consensus around the taxonomy that will guide product development. As we look towards 2021, the ICSF will be tasked to develop those best practice type guidelines that will provide real substance to support PSSL. This will allow institutional investors and other industry stakeholders to develop relevant products against common standards.

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Securities finance revenue slumps

Sam Pierson
Securities finance director
IHS Markit

Global securities lending returns declined 28 percent YoY in September with North American and Asian equities lagging from 2019

Global securities lending returns declined by 28 percent year-over-year (YoY) in September, however as noted in the August snapshot the YoY comparison is substantially affected by North American equity specials for the latter portion of Q3 2019.

In the context of 2020, September was remarkable in its similarity to August, with global returns increasing by 0.2 percent month-over-month (MoM). US equities were the largest contributor to the YoY shortfall, as revenue from specials continued to decline from the year-to-date (YTD) peak in June and was well below 2019 returns.

September was the fifth month of 2020 to deliver less revenue than the 2019 comparable, the others were the months from March to May, along with August. The total Q3 revenue was $2.2 billion, a 16 percent YoY decline. In this note, we review some of the drivers of global lending income in September.

September European equity revenue increased 2 percent YoY, notably completing Q3 with each month posting a YoY increase. That result was largely concentrated in Germany, with the rest of Europe combining for a 16 percent YoY decline in September (like the 15 percent decline in August). German equity lending revenue has been bolstered by hard-to-borrow shares YTD. Varta delivered $14 million in September revenue, the firm's second consecutive month atop the global most revenue generator table. Borrow demand, and fees, for the German battery maker have trended higher since a 8 January report from an activist short seller suggested increased Chinese competition in a category where the firm had been viewed as an exclusive provider. Dutch firm Unibail Rodamco Westfield Se was the second-most revenue generating European equity, with demand for the firm's shares likely driven by anticipation of a rights issue, which was indeed announced on 17 September. The anticipation of Unibail's capital raise was partly informed by a similar course on the part of UK-listed rival Hammerson, which used a rights issue as part of restructuring in August. When the Hammerson rights became tradable in mid-September, the borrow cost for common shares soared, briefly making Hammerson the most expensive to borrow UK equity and ultimately making HMSO shares the second-most revenue generating in UK in September.

Americas equity revenues came in at $224 million for September, a 43 percent YoY decline; compared with August revenues increased by 2 percent. US equity revenues came in at $199 million, a 38 percent YoY decline and 2.6 percent MoM increase. The YoY shortfall was largely driven by the stellar returns from hard-to-borrow shares in September 2019. The surge in returns one year ago was led by Beyond Meat (BYND), which generated $65 million in September 2019 revenues, however US equity revenues would have still declined by 8 percent YoY excluding the impact of BYND shares. August offered limited special situation lending opportunities and September began the same way, however initial public offering (IPO) issuance, demand related to convertible bonds and a handful of other specials pushed revenues steadily higher over the course of the month.

With further conventional and SPAC IPOs on deck for Q4, the uptrend from the Q3 low point in August may have further room to run. A few examples of 2020 vintage IPOs generating outstanding returns include BigCommerce Holdings, Inc. and Lemonade Inc, which generated $4.9 million and $0.7 million September revenue, respectively. Fees for new borrows in AMC Entertainment Holdings spiked on 14 September after a reset provision was triggered for an outstanding convertible bond which increased the number of shares each bond was convertible into, increasing the borrow demand for hedges. The top-three US equity revenue generators Inovio Pharmaceutical, Nikola Corp & Sorrento Therapeutics appear to be driven by directional short demand, with the share prices of each ending September at least 100 percent higher than the start of the year, while also being at least 40 percent below their YTD peak.

Canadian equity lending returns declined sequentially and YoY in September, delivering $24.6 million in revenue, a 63 percent YoY decline, and a 3 percent MoM decline. Cannabis related returns have declined steadily as increased issuance has translated to additional lendable

shares and lower fees. In September 2019 Aurora Cannabis & Canopy Growth combined for $32 million in revenue, a figure which declined 91 percent to $2.9 million in September 2020.

Asia equity lending revenues continue to fall short of 2019, with September revenues of $127 million reflecting a 26 percent YoY decline, however compared with August revenues increased 8 percent. The largest market, Japan equities, delivered $67 million in September revenues, a decline of 23 percent YoY; the shortfall was mostly the result of lower fees, however average on-loan balances posted the first monthly YoY decline since January. Hong Kong equity lending revenues slipped again in September, with $22.6 million in revenues the lowest monthly figure YTD, though still a 2.8 percent YoY improvement. The most revenue-generating Hong Kong equity, Tianneng Power International, has had increasing borrow demand since an activist short seller report was released about the firm in May. Following the release of the report revenue trended higher together for each month, peaking at $3.5 million in August, however balances declined with the share price in September and revenues declined to $3.2 million. The short sale ban in South Korea continues to limit lending revenue, with $11 million in September revenue being the lowest for any month of 2020. SK equity revenues for Q3 totalled $39.6 million, the least for any quarter since Q4 2014.

Global ETF revenues were $30.7 million for September, an 22 percent YoY increase, and 3 percent more than August. On-loan balances averaged $59 billion, a 4 percent MoM increase, but still well below the Q2 average of $65 billion. Global exchange-traded fund (ETF) utilisation increased in September on a marginal decline in lendable value set against the increase in balances. Two of the top three most revenue-generating funds focus on China exposure: US listed Harvest CSI 300 China A-Shares ETF on top with Hong Kong listed ChinaAMC CSI 300 Index ETF ranking third; they were also in the top-three for August, however the two funds switched places in the rankings with the Russell 2000 ETF (IWM) remaining between them. While the revenue-generated in September was low, it's worth noting the increased borrow demand for high-yield credit funds HYG and JNK as well as loans fund BKLN, which corresponded with increased HY credit stress over the last two weeks of September. That may augur well for lending returns for HY products in Q4.

Corporate bond lending revenues continue to lag well behind 2019. Corporate lending returns came in at $32 million for August, a 33 percent decline YoY. Corporate bond lending revenues have been on a steady decline since the post-GFC peak in 2018. Central bank support for global credit has dampened borrow demand while lendable value has increased steadily since April, causing utilization and spreads to both reach YTD lows in September. Despite the widening of the HY CDX index over the last two weeks of September, borrowing of USD HY credit continues to decline.

Government bond lending activity has substantially returned to pre-COVID levels in terms of spread and reinvestment revenue. Global government debt lending revenues totalled $110 million in August, a 3 percent increase YoY and a 6 percent decline MoM. The decline relative to August was due to decreases in balances and fees for US and European sovereign issuers. Average spreads for government debt have steadily declined since April, posting YoY and MoM declines for each month starting with May. Fee-based revenue for US government bond lending came in at $62 million for July, a 3.5 percent YoY increase and a 6.5 percent MoM decline. From the peak revenue in April, the downtrend in spread returns for UST lenders has been steady, with September delivering the lowest monthly return since March. Returns from lending European sovereigns were $37.7 million for September, a 7 percent YoY increase and 4.7 percent MoM decline.

The latter two months of Q3 failed to build on the momentum of a stellar July, with revenues declining 28 percent MoM in August and then increasing 0.2 percent from August's low base in September. Global Utilisation of assets in securities lending programmes posted the first MoM increase since March, which is an upbeat marker after five months of steady declines, even if only a small uptick. Despite the recent challenges, there is cause for optimism in terms of new issuance and other corporate action related trades which are likely to remain a revenue driver in Q4, along with the potential for volatility around the US elections in early November. YTD global returns are down 8.7 percent through September.

Sam Pierson
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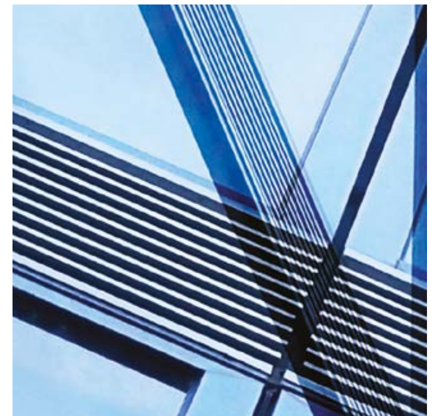

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Comings and goings at Standard Chartered, Clearstream and TP ICAP

MUFG's global head of securities lending solutions Tim Smollen has been reunited with another former-Deutsche Bank colleague in Charlotte Clode.

Clode joins the Japanese banking group as a senior manager in its middle office in London.

"In our front to back business model every role is important and every role touches the client so great to be able to have someone like Charlotte sitting in the middle directing traffic," says Smollen in a LinkedIn post on the hire.

Clode spent the past seven years at Deutsche Bank where she was a vice president operating as part of Smollen's securities lending division.

The pair first crossed paths when Clode began her first stint with Deutsche Bank in 1999 as a member of the securities lending client administration team.

She followed Smollen to Dresdner Kleinwort in the early 2000s and then back to Deutsche Bank in 2013 after Smollen became global head of agency lending in 2009.

Clode is the latest of the former-Deutsche Bank gang to make their way MUFG since Smollen took on the role of spearheading the overhaul of its securities lending business in January.

In June, MUFG Investor Services gained the services of Steven Cassidy who left Deutsche Bank in November 2019 before resurfacing to take on the role of lead technologist in the Americas for the Japanese bank's new securities lending business.

Banu Apers takes the helm of Clearsteam's SBL business in management shake up

Clearstream has restructured its banking, funding and financing team with Banu Apers in the newly-created role of leading all aspects of its securities lending business.

The new formation, which took place in July but has just been announced, saw a number of new roles being created to bring together complementary products and create dedicated leaders of each business sector.

Apers will bring the post-trade provider's lending and borrowing solution under one roof including commercial, product management and product delivery, for the first time.

Jointly with her team, Apers is responsible for the end-to-end delivery of new solutions and the maintenance of the existing customer offerings, such as failed lending coverage (ASL) and strategic lending (ASLplus) across both the central securities depository (CSD) and International CSD world.

Apers has been with Clearstream for nearly eight years and previously head of product management for triparty collateral. She was previously at SWIFT where she served as the senior market manager in its post-trade desk.

Clearstream's securities lending business was previously managed by Fabrice Tomenko, who also oversaw the collatera lmanagement activities.

Tomenko has now pivoted to a role as head of the new Digital Trust team.

There he aims to bring to life new business models based on new technologies such as distributed ledger technology and anticipate market transformations. The Trust's flagship project is the partnership with HQLA^{X}.

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In total a cohort of more than half a dozen former Deutsche Bank colleagues have re-joined forces this year including Bronwen Simms, Jay Schreyer, and Anthony Toscano.

Standard Chartered has unveiled the full management team of its newly-created Financing and Securities Services (FSS) unit, with Margaret Harwood-Jones and Emmanuel Ramambason remaining as co-heads.

As co-heads they will report to Roberto Hoornweg, global head of financial markets. The unit combines existing securities services and portfolio risk management teams.

It consists of all existing securities services activities including securities lending — led by Sunil Daswani.

It will also house portfolio risk management activities across prime services, money markets, central funding desk, credit valuation adjustment and the modelling and analytics group.

Ann-Marie Pearce has joined TP ICAP as its newest broker from FIS.

The role is a new position, where Pearce will be reporting to Eugene Vitagliano, the securities lending desk head. The role focuses on hard-to-borrow shares.

Pearce, who is based in New York, left FIS after six months. Prior to FIS, Pearce worked as an associate director of sales at EquiLend from January 2017 to September 2019. Before that, she was based at Intercontinental Exchange as a regulation consultant.

She also worked at Randstad as a FINRA regulatory analyst for market surveillance. Prior to that, Pearce has served as vice president for multiple companies including Jefferies & Company, Fortis Bank and ING.

Pearce tells SLT: “I’m so excited to be back in securities lending. I enjoy the fast pace and clearly defined role of a securities finance trader.”

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