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Cum-ex: legal opinions are no sure defence, warn tax experts

Individuals involved in cum-ex prior to 2012 will not be spared from prosecution by producing legal opinions from the time, warn Rahman Ravelli lawyers.

Up to 600 names are understood to be on a list in the German prosecutor's office, representing the full gamut of individuals from all role functions and levels of seniority related to what is now perceived to be a wide-spread conspiracy to cheat European tax authorities by double-claiming on dividends.

"The complexity of the trade structure and the indemnity of legal advice gives a presentation of legitimacy, but now that the authorities are catching up and there have been whistleblowers they are picking away at the advice," explained Neil Williams, legal director at Rahman Ravelli, on a webinar discussing the recent cum-ex cases in Europe.

Speakers pointed to the landmark case heard in Bonn, Germany, earlier this year where two former HypoVereinsbank (HVB) — now part of UniCredit — traders were found criminally liable of tax-related fraud and handed suspended sentences, to emphasise this point.

During this case, the defendants highlighted legal opinions gained at the time which stated that short-term trading over dividend dates was legally sound, but this was not accepted by the judge.

The legal stance in Germany is that these trades had no utility in terms of benefitting from voting rights or movements in share price due to the short holding period and therefore their only use was to gain a tax credit.

Also on the webinar, Syedur Rahman, legal director at Rahman Ravelli, reinforced this point, warning that the authorities "will not take this lightly".

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Cum-ex: legal opinions are no sure defence, warn tax experts

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"As far as prosecutors are concerned entities that filed tax rebates must be held liable," he told audience members. "Prosecutors won't agree with the fact that you received legal advice approving these trades. As far as they are concerned, this was bad legal advice that was commissioned to interpret the law in favour of share traders and investment bankers."

However, how prosecutors seek remedies and from whom will depend on the jurisdiction. For example, Germany, the market most affected by cum-ex, does not have the concept of criminal liability of corporations so it will always be individuals within them at risk.

Financial institutions can be handed fines — UniCredit paid a €9.8 million penalty for HVB's cum-ex activities — but prosecutors are "more interested in going after individuals," explained fellow webinar speaker Christian Pelz, a specialist tax lawyer at Munich-based Noerr.

That means "all hierarchical levels and all functions within the institutions," he adds.

Legal experts predict the upcoming case of Hanno Berger, named as the legal mastermind behind the trade structure used in cum-ex, will shed more light on where culpability starts and ends in an entity's hierarchy.

The hearing was meant to start on 20 October but has been postponed until 20 January due to the COVID-19 pandemic.

Although European tax authorities are understood to be the worst affected by double dividend claimants, many of the traders now potentially liable are based in London.

For those UK-based individuals, Williams says that what charges, if any, are brought will depend on the individual circumstances of the case.

"What is clear is that merely going through the motions of obtaining advice, which on the face of it may provide some comfort, will not afford a blanket defence if the evidence and circumstances suggest that there were additional factors which would negate the reliance which could be placed upon the advice," he tells SLT.

A junior trader, he explains, may be able to claim that they queried whether legal advice had been sought on trades and then relied upon that being given in good faith.

In terms of those giving advice, "questions regarding the legitimacy of the advice will focus on whether it was negligently provided, or whether there was greater culpability involved," Williams says.

During the Bonn case, German prosecutors sought to indict some lawyers involved in providing advice, which Williams argues show that the authorities there suspect more than mere negligence in certain cases.

Webinar speakers advised viewers to begin internal reviews to define if any risk of culpability exists. Moreover, self-reporting to authorities and cooperating fully with an investigation is likely to result in a reduced penalty, such as was seen in Bonn.

MarketAxess gains Goldman Sachs as US corp bond market maker

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Volume conducted through Open Trading grew to $643 billion in the first three quarters of the year, up 60 percent from the same period the prior year, and represents 32 percent of MarketAxess’ total global credit trading volumes.

The enhanced global liquidity offered through Open Trading drove estimated transaction cost savings of $852 million for both liquidity takers and liquidity providers in the first three quarters of 2020.

UAE exchange sees Al Ramz Capital conduct first short selling trade via new facility

Al Ramz Capital, a United Arab Emirates (UAE) brokerage, has become the first firm to execute a covered short sale and stock borrow via Abu Dhabi Securities Exchange’s (ADX) newly-launched facility.

ADX recently unveiled a revised and enhanced securities lending rules framework alongside a new covered short selling facility.

Among the main amendments to the lending rules is a requirement for the borrower to return the shares at the request of the

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lender at any time during the period, unless otherwise agreed.

The revised guidelines paved the way for the launch of the covered short selling facility hosted by the exchange which comes after the Securities and Commodities Authority approved ADX's short selling guidelines in 2012.

Earlier this month, Al Ramz Capital, a subsidiary of Al Ramz PJSC, a Dubai-based investment firm that offers asset management, market making, liquidity providing, and brokerage services, became the first firm to utilise the service.

Details of the trade and other counterparts are not publicly available.

Dhafer Sahmi Al-Ahbabi, chair of Al Ramz PJSC, describes the occasion as "an important step forward in the development of regional capital markets".

"We are proud to be a part of this development and we commend ADX for achieving this milestone," he adds.

Also commenting on the first trade, H.E. Mohamed Ali Al Shorafa Al Hammadi, chairman of ADX, says he is pleased to gain buy-in for the facility from one of UAE's "top brokerage firms".

"The launch of the covered short selling service is part of the exchange's strategy to support the diversification of investment tools and providing investors with a broader range of hedging mechanisms," he explains.

DTCC launches enhanced money markets service

The Depository Trust & Clearing Corporation (DTCC), the market infrastructure for the global financial services industry, has launched an enhanced version of its money markets kinetics service to deliver more frequent updates to critical data.

DTCC money market kinetics provides insights into the $3 trillion money markets, "now with more timely and comprehensive access to that

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data," according to Tim Lind, head of DTCC data services.

The bolstered service has been launched to help provide increased transparency into the volatility that has been impacting money markets since the start of the COVID-19 pandemic.

The update of DTCC's money market kinetics service is aimed at delivering data on money market instruments on a more timely and comprehensive basis.

Data will now be delivered every 30 minutes and users will also receive additional data fields such as country code, sector, and duration from issuance to support, what DTCC describes as, advanced market and issuer analytics.

Additionally, users will now get access to an end-of-day file, containing all transactions for that day.

With these updates, clients will receive a more timely and detailed view of the sectors and countries that are driving the money markets throughout the day, DTCC says.

A statement by DTCC states that this will help "facilitate deeper insights into market sentiment and better-informed business and investment decisions".

DTCC money market kinetics provides daily and intraday feeds of anonymised commercial paper and institutional certificates of deposit, secondary settlement transactions data to enhance the analysis of this significant market leveraging data from DTCC's settlement subsidiary, the Depository Trust Company.

AxiomSL to be acquired by PE firm Thoma Bravo

AxiomSL, a provider of cloud-enabled risk management and regulatory solutions, has agreed to allow Thoma Bravo, a private equity investment firm, to acquire a controlling interest in it.

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The transaction is expected to close by the end of the year, subject to customary closing conditions. Financial terms were not disclosed.

Founded by CEO Alexander Tsigutkin and CTO Vladimir Etkin in 1991, AxiomSL serves its clients, which includes banking, investment management, broker-dealers and commodity trading institutions, through ControllerView, an intelligent data management and analytics platform.

AxiomSL's platform provides cloud-based, risk management and regulatory solutions, which include over 5,000 risk and regulatory reports across 55 jurisdictions and 110 regulators.

Its regulatory solution covers multiple reporting frameworks including the Securities Financing Transactions Regulation and the European Market Infrastructure Regulation.

Upon closing, Thoma Bravo says it plans to use its "deep expertise in enterprise software, proven operational capabilities and prior experience in complex financial technology markets", to partner with AxiomSL's management team to grow AxiomSL's customer base and drive further innovation for critical risk management and regulatory solutions.

Tsigutkin says: "Thoma Bravo has a proven track record of accelerating innovation and growth at leading software companies, as well as a strong appreciation for our values of client success, integrity with accountability, excellence in innovation, diversity of perspectives and internal and external collaboration.

"AxiomSL's success is a testament to our partnership with the financial industry, and our growth is due in no small part to the contributions of Technology Crossover Ventures (TCV), who has been a critical partner for AxiomSL for the past three years as we grew the franchise at a record pace."

Brian Jaffee, a principal at Thoma Bravo, adds: "We've been following AxiomSL's success for many years and couldn't be more excited to partner with Alex and his team for this next phase of growth."

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Q3 revenue: State Street

State Street's Q3 securities finance revenue decreased 28 percent compared to the same period in 2019.

Revenue reached $84 million for Q3, down from $116 million in the comparable period last year. The bank primarily attributes the drop off to lower balances and spreads.

Revenue also declined 9 percent compared to Q2, mainly driven by lower agency reinvestment rates.

Read full article online

Q3 revenue: BNY Mellon

Revenue for the bank's agency lending business, which sits under its investment services business, came in at $37 million in its third quarter, down 5 percent from $39 million reported in Q3 2019.

Securities lending revenue for Q3 was also down from Q2 when it took in $51 million, which was a two-year record high for quarterly returns.

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Q3 revenue: BlackRock

BlackRock has reported its lowest quarterly securities lending revenue since Q3 2019, following the record-ing-breaking returns it recorded in Q2.

Securities lending revenue hit $153 million in Q3, up from $150 million in the comparable period in 2019 but down from the $210 million achieved in the prior three months.The asset manager says the month-over-month drop off primarily reflected lower assets spreads.

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Q3 revenue: Citi

Citi's markets and securities services revenues for Q3 reached $5.2 billion, a 16 percent increase compared to Q3 2019, which stood at $4.5 billion.

Fixed income revenues of $3.8 billion increased 18 percent compared to $3.2 billion in Q3 2019, while equity markets were also on the up with revenues tapping $875 million, compared to $760 million during the same period last year, marking a 5 percent increase.

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Q3 revenue: J.P. Morgan

J.P. Morgan has revealed its markets and securities services revenue for Q3 totalled $7.8 billion, a 29 percent increase from its Q3 2019 figure of $6 million.

Fixed income revenue in Q3 stood at $4.6 billion, up 29 percent, thanks to strong performance across products, particularly securitised products.

Equity revenue was $2 billion, up 32 percent year-on-year.

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Nikola crowned Q3's highest lending revenue generator

US electric vehicle maker Nikola was the most revenue-generating security in Q3.

Lending revenue from this controversial asset hit $114 million by the end of the quarter and now sits at $189.8 million for the first three quarters of the year combined.

The second-highest revenue-generating security, Varta, only earned lenders $34 million in Q3.

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Master builders: Crafting a global securities lending programme during a pandemic

Drew Nicol reports

SLT speaks to MUFG's Tim Smollen, the global head of the recently-established Global Securities Lending Solutions business, along with Anthony Toscano, head of the Americas, and John Schreyer, head of EMEA and Asia

How is the build going and how has the global pandemic impacted the overall project?

Tim Smollen: Overall, the build-out is going extremely well but that is because I am fortunate to have on my team some very experienced people who have done this before who know what needs to be done. I always say we are a lot like a soccer team where everyone knows which way everyone else is going to cut – you need complete trust in your people to be able to do what we are doing in such a short period of time.

The global pandemic has certainly created some challenges but we were fortunate to have started at MUFG some two months before the lockdowns hit so our project was well underway by that point and so we just continued to push ahead. We have made effective use of frequent team video calls – for me personally, I think it is important to see everyone as often as possible on these calls and we try to have some fun as well. They are good for morale and ensure we stay on the same page at all times.

You and your team have spent a large chunk of your careers with German institutions. How has your experience been working for a Japanese Bank?

Smollen: Having spent a lot of time in Japan early in my career I thought I knew what to expect but I have been blown away by the excitement, enthusiasm and support from across MUFG for what we are building. We now have a number of Japanese nationals on our team and even more supporting us around the world and without them we would not be as far advanced as we are today – they help navigate this very large bank we are a part of and educate us frequently on how things work. I can't really summarise Japanese business culture but if I had to it includes frequent communication, patience, commitment and respect. It is also reflected in a pervasive sense of long-term commitment to clients and a given industry. It is very refreshing to work for a firm that lives and breathes these values every day.

Let's talk about the client side of the business. Can you talk about the types of clients you will be working with/targeting and what would make a client jump from a major custodial programme to MUFG?

Anthony Toscano: During the course of our more than 25 years in securities lending, Tim, Jay and I have spoken to hundreds of investors and gotten their views on what they look for in a securities lending agent. These investors include some of the largest sovereign wealth funds, insurance companies, registered investment companies, pension plans and central banks in the world. Core themes remain constant: they want expertise in securities lending, a well-capitalised and strong balance sheet, global reach, and they want to work with a bank that is relevant to where they are, which conducts itself professionally behind the scenes. Any client who is concerned they are getting lost in the crowd as part of its global custodian's lending programme, wants transparency to their performance and the overall securities finance market, who is looking for an agent who can deliver a stable revenue stream in a manner designed by themselves, backed

by an indemnity from a strong financial institution, will look to shift their securities lending mandate to us.

What's more, as a result of many veterans of the industry having been let go due to cost-cutting at the global custodians, clients are hard pressed to find desks staffed with traders who have experienced multiple interest rate cycles and major market events. That is not the case here at MUFG. We have a team with more than 20 years of experience who can deliver what our clients need and expect, no matter the market conditions.

By all measurements (DataLend, IHS Markit, etc) lendable supply continues to grow to record levels but there is not the same growth on the borrowing/hedge fund side. How do you capture some of that market share? Is there room for another lending agent?

Toscano: Frankly, the usual drum beat of "too much supply, not enough demand" is a cop out. A good securities lending agent is hired for more than just matching lists of shorts to their inventory. It requires a proactive approach, where the lending agent looks at what is not on loan and works to utilise that supply. This requires tracking volatility in the global markets, watching the options markets and panning inventory for affected supply.

Equally important, a good securities lending desk spends time with counterparts to understand their current constraints and works with them on different structures that can help alleviate those pressures. Add in collateral flexibility and automation, and you can understand why market share would be shifted to a new lender such as ourselves.

Can you talk to us about your technology decision/strategy?

John Schreyer: Sure happy to take a technology question. Our ultimate solution is actually a hybrid technology model where the EquiLend-Stonewain system called Spire will be our core platform which will be combined with a number of internally developed applications/tools plus we also utilise other vendor solutions which can give us a competitive advantage. The most important point for our business is to have a platform that provides the utmost flexibility and transparency for our clients. With markets changing so rapidly we wanted a core platform that had the ability to change quickly and at the same time seamlessly work with any of a number of internal/external applications be they data analytics, artificial intelligence or predictive trading to name just a few. I guess you can say what was most important was the criticality of always driving our own agenda by remaining nimble and able to react quickly.

Can you talk about the key requirements when setting up new trading desk(s)?

Schreyer: Sure. For me, it is all about finding a way to match the needs of the clients to the binding constraints of the borrowers. We really are in a unique position to be able to do that.

The first key requirement is going to be our technology. Setting up the trading desks around the globe on one cutting-edge platform will allow us to be more proactive in our trading than ever, whilst answering the daily needs of the borrower. It will allow us to be extremely efficient, so our traders can direct their attention to the important topics that will drive our success rather than getting bogged down processing tickets whilst juggling compliance checks. It will give us the ability to create a network of small, dynamic, focused and interconnected trading desks that will have the time to work on creating the solutions that our clients and the street needs. Our unique position also gives us the chance to establish brand new, and completely up-to-date lending agreements that will mean we will not be tied in knots by having legacy agreements that require a huge effort just to update.

If you can look into your crystal ball, where do you see the GSLS business in five years' time?

Smollen: We don't care about league tables or survey results. Instead we care about building a world-class programme that will meet the needs of many of MUFG's highly prestigious clients which demand and expect the best. I also expect to build and deliver the leading third-party lending programme in the world where we want to be the first choice for beneficial owners who want better performance and service.

I can promise you this programme has the right blueprint, talent and fundamentals required to make it one of the most compelling programmes on the street and what we believe will be the only true global agency securities lending programme with trading desks around the globe covering all asset classes with its roots in Asia.

We clear the path

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

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

OCC

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Resilience in the face of disruption

Drew Nicol reports

RBC's Don D'Eramo appraises how the major revenue trends of 2020 so far, including COVID-19 and the rise of SPAC IPOs, are being offset against hyperactive central banks dishing out alternative sources of liquidity

Despite ongoing challenges presented by COVID-19 in 2020, the securities lending industry continues to demonstrate resilience. As a result of robust risk management practices, the industry experienced little to no financial impact during the recent period of significant market stress. This was managed alongside the implementation of two significant and complex regulatory initiatives. Throughout these months, it was imperative that we maintained open lines of communication with our beneficial owners and counterparties to address volatility concerns and provide clarity around the regulatory changes. Meanwhile, the market continues to evolve as intrinsic value opportunities re-emerge and macro-economic policy changes affect demand drivers for high-quality liquid assets (HQLA).

How has the securities lending industry managed regulatory change during COVID-19 and what impact has this change had on stakeholders?

The initial phase of the Securities Financing Transactions Regulation (SFTR) was implemented in July, followed by the EU's revised Shareholder Rights Directive (SRD II) in September. While SFTR reporting obligations initially apply to counterparties, the next phase of implementation in October extended the requirements to beneficial owners. SFTR is a complex undertaking and, so far, implementation has been successful. Industry associations have provided tremendous support to participants in clarifying the new regulatory requirements. Looking ahead, the SFTR agenda remains a key focus across the industry. Agent lenders, buy/sell side firms, vendors and trade repositories will continue to deploy system enhancements to facilitate the new regulatory requirements. Best practices will evolve and ongoing advocacy efforts by industry associations will help ensure that the technical requirements are implemented in a practical manner.

SRD II went live shortly after the July implementation of SFTR. As of 3 September, intermediaries such as agent lenders are responsible for disclosing shareholder information if requested by issuers within applicable EU member states. SRD II is an important evolution of the marketplace and can be viewed in lockstep with sustainable finance principles and environmental, social and governance (ESG) investment practices. It should be noted that, similar to ESG, SRD II does not impede securities lending. While agent lenders now have a reporting obligation, beneficial owners retain their right to exercise proxy voting on any security held within their invested portfolio. As such, clients must continue to request a temporary recall of the security from the borrower or mandate their agent lender to proactively recall securities based on publicly available information. The latter action is typically taken only by a small group of beneficial owners who frequently exercise their voting entitlements and have taken into account the relevant revenue considerations. This process remains well defined across the industry globally.

Given current market conditions, where do you see opportunities for incremental value?

Global demand for specials has been declining since its peak in 2018 and 2019 when the frequency of 'hot' and 'white hot' securities was high. Although we see fewer specials in today's market environment, opportunities to gain incremental returns on intrinsic value opportunities continue to arise, albeit from slightly different avenues. Corporate events, for example, have historically presented value opportunities in the securities lending market through initial public offerings (IPOs) or mergers and acquisitions activity, resulting in exchange offers and other corporate events. So far in 2020, we have seen fewer IPOs but they have not disappeared entirely including a series of announcements since August (for example, Airbnb, Palantir and Snowflake).

The pandemic and resultant market volatility have also created alternative opportunities through Special Purpose Acquisition Company (SPAC) offerings. SPACs have accounted for almost half of all IPOs so far in 2020. Demand for these non-traditional 'reverse offerings' is generated by two factors: implicit spreads between event options and directional investor sentiment.

While such events may look different, the inherent incremental returns are similar and perhaps even greater than traditional IPO events. In addition, traditional corporate events such as exchange offers, dividend reinvestment plans and scrip issues continue to provide pockets of intrinsic value. In order to capitalise on such events, the experience of the agent lender and the relationships on both sides of the trade — with beneficial owners and counterparties — are vital given the time-sensitive nature of these opportunities.

How have the actions of central banks impacted the securities lending market?

Recent fluctuations in the demand for fixed income securities highlight the effects of macroeconomic factors on lending. In past years, fixed income loan balances have exceeded equities, primarily driven by demand for HQLA to support liquidity requirements and attributable to key financial resilience reforms stemming from the 2008 credit crisis. This resulted in larger open balances and significant demand for term loan structures. However, we continue to see this trend reversing in 2020, given the substantial liquidity that currently exists across global financial markets.

Volatility experienced earlier this year has necessitated significant central bank intervention to control inflation and ease liquidity concerns. The Bank of Canada and US Federal Reserve quantitative easing (QE) programmes, in addition to all-time-low interest rates, are providing alternatives to the liquidity once sought in the securities lending market. As a result, demand for additional term lending has softened and a number of financial institutions have reduced existing structures taken on prior to the COVID-induced market decline. In Canada, such demand has been concentrated around level one and level two assets, Canadian government bonds and provincial debt. While demand for Canadian government bonds persists, albeit at lower levels, demand for provincial debt has tapered due to alternative sources of liquidity and collateral optimization. In comparison, significant appetite continues to exist for the borrowing of US treasuries. As we approach 2021 a key focus across the industry will be on further central bank actions, which have the potential for additional impacts on demand for term lending.

> ***Volatility experienced earlier this year has necessitated significant central bank intervention to control inflation and ease liquidity concerns***

Donato (Don) D'Eramo
Global head of securities finance
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Brexit is complicated, but your trade reporting doesn't have to be

Val Wotton
Managing director of product development and strategy, repository and derivatives Services
DTCC

DTCC outlines how Brexit will affect reporting requirements on either side of the English Channel by creating new challenges

From the pandemic-driven market volatility to the go-live of Securities Financing Transactions Regulation (SFTR), 2020 has been a year of disruption for the industry. And there's more to come.

On 31 December, the Brexit transition period will end and the UK will officially leave the EU. At that time reporting obligations imposed by the European Market Infrastructure Regulation (EMIR) will continue to apply in the UK as provided for by the UK-EMIR and UK-SFTR which come into force and impacted firms will need to be ready to manage their derivatives and securities financing trade reporting with the European Securities and Markets Authority (ESMA) in the EU and the UK's Financial Conduct Authority (FCA) as applicable.

Challenges of two-jurisdiction reporting

Brexit preparation has not been straightforward for market participants. Repeated changes to the calendar forced firms to start and stop their planning several times, in turn forcing them to allocate, then reallocate resources to tackle all the operational and business updates needed to be ready for the divorce.

With that date now fixed and approaching quickly, we see that firms are seeking ways to ease the burdens of transitioning to post-Brexit operations. One such burden is bifurcated trade reporting – that is, reporting trades to two different authorities, one for the EU27 (ESMA) and the other for the UK (FCA). Such an arrangement is not only operationally challenging, it can add unnecessary costs.

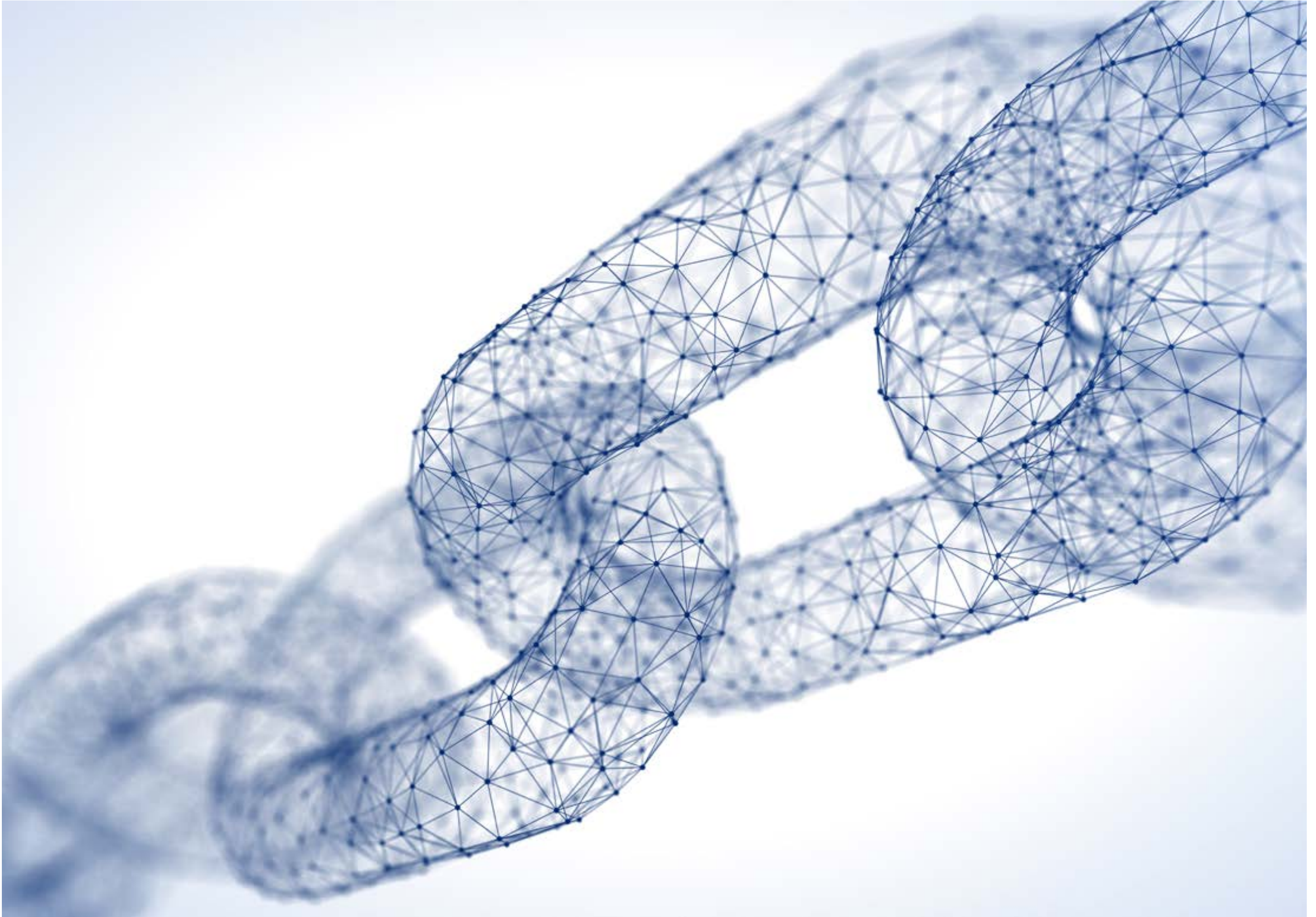
A better way – less costly, more efficient – is to utilise an approved trade repository that can operate in both regulatory ecosystems post-transition.

Simplified reporting

DTCC, the industry's premier post-trade infrastructure, will offer our clients end-to-end trade reporting solutions in both the UK and EU through our Global Trade Repository service (GTR). DTCC Data Repository (Ireland) PLC (DDRIE), based in Dublin, will provide EU27 trade reporting while DTCC Derivatives Repository PLC (DDRL) will serve UK reporting.

With its global reach and multi-product functionality, GTR is a one-stop shop that can enable users to meet their regulatory reporting obligations wherever they are located via a single platform. For both ESMA and FCA-required EMIR and SFTR reporting, DTCC clients will be able to continue sending the same data to the same place over the same connectivity with a service delivered to the same pre-Brexit service level agreements.

For targeted assistance in making the post-Brexit transition, DTCC Consulting Services is also available. Our recently launched consulting offering is designed to help clients take a strategic approach in addressing the numerous regulatory, financial and operational challenges related to their post-trade ecosystems.



The future is now

Natalie Turner reports

Blockchain is an increasingly appealing option for financial institutions to improve securities lending practices and 2020 is arguably the year adoption went into high gear

Despite recent innovations, the process of transferring underlying securities between parties of a securities lending trade can still take up to several days and involve multiple intermediaries. However, through the emerging technology that is blockchain, financial institutions could reduce costs, increase efficiency, and execute transactions instantly and directly between the two parties, according to its advocates.

Momentum has been building over the years as blockchain peeks its head over the horizon. Progress began in earnest a few years ago with instances such as Deutsche Boerse backing HQLA^{X} in 2018 to develop its blockchain-powered solution for the securities lending market. However, widespread adoption of this new technology has so far failed to reach critical mass — until now.

Arguably the year's biggest endorsement of blockchain technology came from the Options Clearing Corporation in May when it unveiled an ambitious plan to overhaul its aging securities lending clearing infrastructure with a distributed ledger technology (DLT) platform.

"The system is highly-automated and uses shared smart contracts to perform settlement and life cycle events," says Matthew Wolfe, OCC's vice president of strategic planning and development. "The efficiency and automation will reduce costs, manual intervention, and errors. The system is also designed to automatically synchronise that golden copy with all nodes on the network."

"This will allow lenders and borrowers to share a near real-time view of their contracts and transactions, which can further reduce errors and the challenges associated with legacy reconciliation processes," Wolfe adds.

The project is being managed by Axoni, a New York-based technology firm that specialises in multi-party workflows and infrastructure and will be built on its flagship distributed ledger protocol, AxCore. An update on the timeline for a soft rollout is expected before the end of the year.

Another conversion occurred in Israel. Despite being one of the largest securities lending markets in the Middle East, Israel has lagged behind its Western peers. Now, it is potentially on the brink of a technological revolution with the Tel Aviv Stock Exchange (TASE) set to launch a first-of-its-kind distributed ledger technology venue dedicated to facilitating securities lending. The platform is due to go live in November and aims to give a much-needed injection of life into the country's lending market.

Ofer Abarbanel, founder of Contact Prime Brokerage, a firm which specialises in the securities finance sector, explains that the exchange's top management realised they needed to become more competitive so they could increase their value to its shareholders, therefore, they invested in improving their technology and turned to blockchain.

Similar initiatives are underway at boerses in Malaysia, Singapore and Spain, although none are as far along in development.

Elsewhere, more established blockchain-powered service providers such as Lendingblock, a securities lending exchange for digital assets that went live in 2019, along with SETL and Digital Asset continue to develop their product suites and present what they say is a more efficient way to do business.

Finally, trade bodies such as the International Securities Lending Association (ISLA) and the Risk Management Association (RMA) are making the development of digitisation, which lays the foundation for DLT adoption, a headline policy for the coming months and years.

But, is 2020 the year blockchain finally goes mainstream?

What are the current problems with the securities lending market?

The securities lending market at present, poses problems which create operational inefficiency by virtue of being a series of disjointed bilateral relationships, explains Matthew Phillips, COO and head of delivery at Trading Apps. The industry boasts some secure, well-managed pre-trade activity, but far too many processes are carried out on email and spreadsheets, for example: managing availability and trade lifecycle, he argues. "It is a very opaque market as supply and price data is available to some, and not others," Phillips adds.

Phillips notes that there is limited data and process standardisation. For instance, close-of-business prices and foreign exchange rates are agreed between counterparties, and then different ones being used for the same security with another counterparty. This is in spite of ISLA's best practice guide recommending using Bloomberg to standardise these figures.

"There are multiple vendor solutions which look to solve/fix the symptoms of the problem, such as contract compare and billing compare. However, a lot of manual intervention is required, making the process inefficient and prone to further error," he adds.

Greg Chew, CEO at QPQ, which is developing a DLT-based network infrastructure to enable a fully-digital ecosystem for transactions to be initiated and settled, also acknowledges that securities lending is "by its very nature, more burdened with administration than most sectors". At its simplest, Chew says, the two major problems facing the security lending market today are time and cost. Both these issues relate to the number of intermediaries and the fees they all charge, he adds.

Wolfe reinforces this argument. When OCC was in the early phase of planning its new clearing system as part of its Renaissance Initiative, it conducted a survey of industry participants about what their greatest pain points were.

Wolfe explains that there were three common responses: "Annual

processing, errors, and escalating costs. These pain points largely stem from the daily reconciliation process between the lender and borrower's record of contracts. There are regularly scores of discrepancies that require manual investigation and adjustment."

What could be resolved through blockchain?

Since adopting blockchain technology, firms have seen a more automated process of trust by creating a digital ledger of data that stakeholders have access to, explains Chew.

"There is no need for third-party trust intermediation because the data itself — repeatedly confirmed across the distributed nodes — is the proof of truth. DLTs securely record and store all transactional data in an immutable and auditable manner, finally creating the level of transparency that regulators want to see in the financial industry," he adds.

Phillips highlights that blockchain provides certainty of participant identity, coupled with certainty of the ownership and provenance of assets, and therefore it is no surprise that the technology is gaining traction in the supply and manufacturing chains.

"It is in these chains that assets have a 'digital twin' stored in the blockchain, wherein the ownership is moved instantly through transactions which update the asset owner," he says.

Elsewhere, Wolfe states that as a systemically important financial market utility OCC has very high standards regarding security, performance, resiliency, and recovery. The clearinghouse conducted a proof-of-concept to validate whether a DLT-based system could achieve these standards and Wolfe says it "met or exceeded the non-functional standards".

"Therefore we felt that we could deliver a system that addresses the industry's pain points and allows OCC to better serve market participants without making any trade-offs," he concludes.

Why this technology as opposed to another?

There are many service providers and fintech start-ups claiming to be positive disruptors of the market and touting one form of technological innovation or another, but DLT stands alone in one key area: reporting.

In a blockchain solution, it's possible to have the regulator on a node in the network, which cuts the cost and complexity of reporting, while also increasing the accuracy and volume of information available to the regulator.

Speaking to SLT in 2017, IBM's vice president of global financial markets, Keith Bear once said "utilising a blockchain solution would help make areas of the market, such as reporting, much more efficient. It could potentially remove the need for trade reporting all together, which is a mounting concern in the securities lending market with the introduction of unique trade identifiers."

Any form of systems overhaul is difficult, and increasingly so the larger the firm in question. Moreover, securities finance is at the heart of many institutions, linking internal desks, client coverage, settlements, financing therefore all these internal networks are impacted by change.

This is why Duncan Johnston Watts, CEO of Blockchain Technology Partners, which is working with TASE on its platform launch, says the exchange's adoption of blockchain was a "bold step to not only innovate by creating a market for its members but also by adopting a distributed systems architecture rather than the classic hub and spoke model". Blockchain is one of the key enabling technologies that allowed TASE to achieve this, he says. For example, in many instances of securities lending, there is no automated linkage between accounts that indicate where the collateral should go back to, which slows down the process.

A scalable DLT-based platform would reduce manual intervention in the process, which, in turn, would make it faster and create a more transparent record for reporting purposes, as well as, reduce the cost of the transaction as there would be no need for costly intermediaries to facilitate said transaction.

Additional benefits of DLT could be the redistribution of collateral liquidity more efficiently via the enhancement of the interoperability of securities pools residing in various settlement systems and locations.

It is yet to be seen if the future of securities lending is on a blockchain, but 2020 may one day be seen as the year that the adoption of DLT more broadly moved from the industry's periphery to the mainstream. With many industry players around the world on board and already identifying the problems in the securities lending workflow and how blockchain technology will circumvent them, the time may one day come when technological innovation will crowd out the intermediaries in the sector for the benefit of the key stakeholders involved in securities lending transactions.

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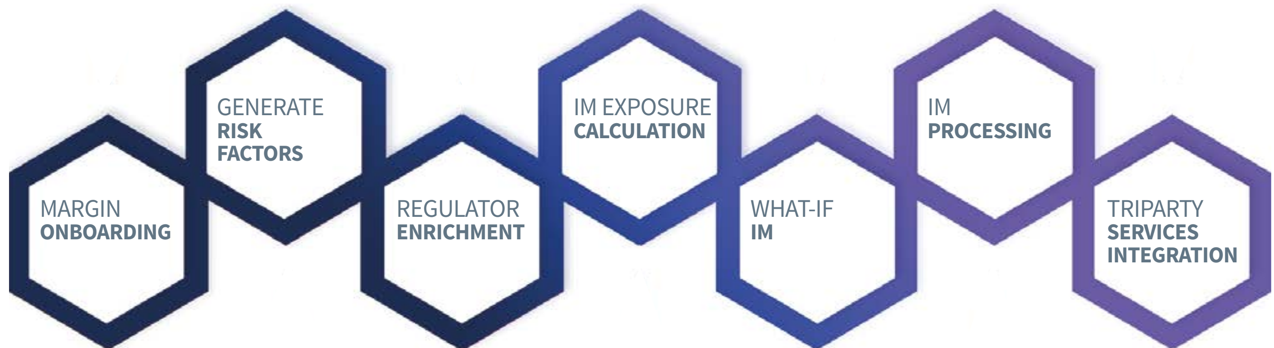

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A year like no other

David Lewis
Senior vice president
FIS, Astec Analytics

FIS Astec's David Lewis reviews how the year's unprecedented events have impacted securities finance revenue compared to prior years

To say that 2020 has been an unusual year pushes the limits of the definition of 'unusual'. So much has changed across the globe, and some of it will never go back to where it once was. Much has been said over the years about the fundamental place the activities of securities finance and collateral management occupy in the wider financial markets. The lubricant of the capital markets has been used more than once to describe securities lending, while the short interest activity that forms just one part of the complex demand drivers behind the business has been described as the tool that promotes price efficiency and early warnings of forthcoming shocks.

Behind all this, of course, is the requirement for securities finance to be a profitable business. 2019 saw strong revenues, pushing over $10 billion for only the second time since 2008. 2018 was the only other year to breach $10 billion in the past 10 years, and 2019 revenues represented a drop of around 6 percent compared with the prior year. The spread of income generation across the two years was more than uneven, with several special securities and situations coming to the rescue of the overall levels of revenue earned.

The 2020 impact on securities lending

This year so far has seen a very specific specials situation in light of the global COVID-19 pandemic. As an industry that excels during volatility, the first quarter of 2020 appeared to be very good for securities lending markets. As global economies shifted toward the realisation of what was unfolding, some hushed conversations around the market discussed the positive revenue impact that these events were having. But, has it lasted and did those revenue gains really materialise?

We are only just entering the final quarter of 2020 and, with the past nine months exhibiting such an unpredictable nature, it may be an error to make any significant assumptions about what is yet to come, but we can take a good look at what has happened.

Understanding market availability

Figure 1: Market availability 2019 to 2020

At the highest level of aggregation across the global data pool managed by Astec Analytics, we can see some stark but perhaps not surprising differences between 2019 and 2020. It will come as a surprise to few that availability is up. Many observers have noted the entry of new funds into the securities lending market, seeking additional alpha for funds suffering in the global economic slowdown. Many others have added securities lending participation to their funds in order to replace management fee income.

Figure 1 shows a quarter-by-quarter comparison of asset availability between the two years. An average is shown across each quarter, including the first days of the fourth quarter of 2020. It is important to note that the values shown are in units of availability rather than monetary value, where one share and one unit of a bond each constitute one unit of lendable asset.

Through 2019, as figure 1 shows, volumes were relatively static apart from the third quarter which exhibited an 8 percent reduction compared to the rest of the year. Looking into 2020,

availability was up across the first three quarters, by 6, 4 and 18 percent respectively. With only 20 days of the fourth quarter having passed at the time of writing, care should be taken with the illustrated drop of 7 percent compared with the same period in 2019, but it could be an early sign of some funds closing out their securities finance activity as a result of policy or regulatory changes. These can include a view that securities lending may be contrary to aspects of their environmental, social and governance (ESG) principles, while short selling bans in some countries may have encouraged others to exit.

Figure 2: Comparing loan volume and count

Looking at the demand side of the equation throws up some interesting statistics. Figure 2 compares loan volume for each quarter across 2019 and 2020, again in units of assets rather than value. These results may be a little more surprising than those around availability. Loan volume has remained relatively static; it is lower in every quarter, but perhaps by less than expected. As figure 2 illustrates, the changes are small, specifically -1, -6, -1 and -6 percent respectively.

A starker difference, perhaps, shows in the change in loan count. Last year has an average open loan count of just under 1.8 million while 2020 was closer to 1.63 million, or around 9 percent lower, on average, per quarter. In addition, average trade durations were down in three of the four quarters, so far, of 2020, compared with 2019. The first quarter, as the pandemic began to ramp up showed a small increase from 111.2 days to 112.7, while the past three quarters together each showed a drop of 9, 3 and 1 percent respectively.

Average fee and rebate rates

The final component in this analysis must, of course, be average fee and rebate rates. With utilisation down due to the additional supply in the market rather than a significant change in overall demand, the all-important revenue results hinge on asset values and fees charged. The impact on fees when comparing 2020 to 2019 is quite dramatic. Each quarter shows a drop compared to the same period in the prior year, with quarterly comparisons being 11, 12, 24 and 18 percent down (for Q4 2020 this is based on the average to date only). Add this to falling durations, then the downward impact on revenues is unavoidable and obvious.

By each of the first three quarters, 2020 shows revenues dropping by 11, 6 and 21 percent respectively. There is a small spark of optimism when looking at the last quarter; extrapolating the first 20 days of revenues suggests a 4 percent gain over the last quarter of 2019, but this is based on just 20 days with 72 yet to go and should not be taken as a reliable indicator of revenue expectations.

2018 was a bumper year for securities finance with 2019 demonstrating a good year but with a semblance of reality thrown in. By contrast, 2020 has thrown all norms out of the window with the uncontrollable factors of demand dictating the outcomes for us all. What has shown through, however, is that securities finance remains a fundamental part of an efficient financial marketplace, delivering a resilient and efficient service to all its stakeholders, generating valuable incremental income along the way.

David Lewis
Senior vice president
FIS, Astec Analytics

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Comings and goings at Delta Capita, FIS and Margin Reform

Former-AIG collateral management chief Sue McGillion-Moore has been appointed as Margin Reform's new partner and Americas Practice lead.

McGillion-Moore, who is based in New York, joins from MBO Partners, where she worked as a contractor, specialising in collateral management assisting KPMG US build out its collateral and liquidity management framework.

She also spent two years as KPMG US' global head of collateral management from 2012.

Prior to her contracted work, McGillion-Moore was a director at AIG where she served as global head of collateral management for three years working across the global capital markets.

Before then, the collateral management industry expert operated as an executive director at UBS for one year, specialising in prime brokerage, stock borrow loan margin and collateral.

McGillion-Moore also worked for JPMorgan Chase in the nineties for six years in a number of roles including vice president for North America in over-the-counter derivative collateral management.

She moved over to Merrill Lynch in 2000 where she stayed for seven years focusing on equity finance before returning to JPMorgan Chase in 2007 to spend three years as executive director and global head, strategic prime brokerage margin and collateral programme.

Martin Wingate swaps Calypso for FIS

Calypso Technology's former market specialist Martin Wingate has joined FIS as its business solutions consultant.

Wingate left Calypso, the software application provider, last month after just over seven years liaising with prospective and existing clients to ascertain their needs and system requirements.

He also provided recommendations on best market practice and regulatory initiatives to assist with product development.

Prior to that, Wingate was a COLLINE product consultant at Vermeg (formerly Lombard Risk), the Tunisian financial software developer, where he served for 18 months.

Before then, Wingate served at Daiwa Capital Markets Europe for six years as head of collateral management.

He also worked as OTC head of collateral management for Morgan Stanley from 2000 to 2005.

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Delta Capita, a global provider of managed services, solutions and consulting, has appointed Peter Mayberry to the newly-created role of managing principal to lead client delivery.

The former British Nuclear Submarines officer will take responsibility for implementing technology solutions for customers. He aims to help advance the firm's mission for managed services and effectively assist organisations in reducing costs.

In a statement on the hire, Delta Capita reveals it has ambitious growth plans for its managed services offering and says that Mayberry will be "instrumental" in delivering this for clients.

Delta Capita's managed services offering includes post-trade and other trade lifecycle services across all asset classes; client lifecycle management; structured retail products; pricing and risk and prytek, a technology-based operations as a service.

Mayberry joins from Capco where he spent the past nine years as the delivery lead for strategic clients and was directly responsible for delivery across multiple functions, including compliance, anti-financial crime and risk reporting.

Before Capco, Mayberry spent six years as a warfare officer in the Royal Navy, including two years aboard HMS Vanguard, a British nuclear submarine equipped with intercontinental ballistic nuclear missiles.

Steve Vinnicombe, head of consulting and solutions at Delta Capita, says: "Peter Mayberry is the ideal person to lead our delivery team at Delta Capita. Not only does he have a first-class track record of managing complex change throughout the financial services value chain, but he is equally adept at nurturing client relationships as well as building and leading teams."

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