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Banks to become as safe as houses

The Basel Committee on Banking Supervision has finalised exposure standards that will help to protect banks from significant losses after counterparty failure.

The final standard sets out a supervisory framework for measuring and controlling large exposures. It will take effect from 1 January 2019.

A large exposure framework protects banks from significant losses caused by the sudden default of an individual counterparty or a group of connected counterparties.

The framework was designed so that the maximum possible loss a bank could incur would not endanger the bank's survival as a going concern, said a release from the Bank of International Settlements (BIS).

In cases where the bank's counterparty is another bank, large exposure limits will directly contribute towards the reduction of system-wide contagion risk.

By extending the scope of coverage to exposures to funds, securitisation structures and collective investment undertakings, the Basel Committee believes that the framework is also a useful tool for strengthening the oversight and regulation of the shadow banking system.

The large exposure standard published includes a general limit applied to all of a bank's exposures to a single counterparty, which is set at 25 percent of a bank's Tier 1 capital. This limit also applies to a bank's exposure to identified groups of connected counterparties (ie, counterparties that are interdependent and likely to fail simultaneously).

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SEC resolves rebate rate plea

Securities lending agents can renegotiate rebate rates following a February US Securities and Exchange Commission (SEC) decision to allow U.S. Bank National Association to do so on behalf of its client, Nuveen Advisors.

In a short article commenting on the decision, law firm Ropes & Gray quoted section 17(e)(1) of the 1940 Act, which prevents persons who are affiliated with a fund from accepting compensation for the purchase or sale of any property to or for a fund.

A bank that provides custody of fund assets may be deemed to be an affiliated person of that fund if it acquires ownership or control of specified amounts of the voting securities of that fund through its other investment management activities.

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Collateral dipped in 2013, finds ISDA

The estimated amount of collateral in circulation in the non-cleared OTC derivatives market decreased 14 percent from $3.7 trillion at the end of 2012 to approximately $3.17 trillion by December 31 2013, according to the 2014 International Swaps and Derivatives Association (ISDA) Margin Survey.

The survey was presented at ISDA's general meeting in Munich recently. The collateral decrease can be attributed to a rise in mandatory central clearing, found the association.

Active agreements supporting OTC derivatives transactions reached 133,155 at the end of 2013. Almost 90 percent of those were ISDA deals.

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Banks to become as safe as houses

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A tighter limit will apply to exposures between banks that have been designated as global systemically important banks (G-SIBs). This limit has been set at 15 percent of Tier 1 capital.

This final standard takes into account comments on the committee's March 2013 proposals.

The initial proposal has been revised, setting the definition and reporting thresholds at 10 percent of the eligible capital base (instead of the 5 percent initially proposed).

The treatment of a limited range of credit default swaps (CDS) used as hedges in the trading book has also been modified so that it is more closely aligned with the risk-based capital framework.

Furthermore, the initially proposed granularity threshold for exposures to securitisation vehicles has been replaced with a materiality threshold related to the capital base of the bank (calibrated at 0.25 percent of the capital base), and a treatment that recognises particular features of some covered bonds.

The Basel Committee will, by 2016, review the appropriateness of setting a large exposure limit for exposures to qualifying central counterparties (QCCPs) related to clearing activities, which are currently exempted. It will also review the impact of the large exposures framework on monetary policy implementation.

The committee has emphasised that a key lesson learned from the financial crisis is that banks did not always consistently measure, aggregate and control exposures to single counterparties across their books and operations.

Large exposures regulation has arisen as a tool for containing the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency.

A separate key lesson from the crisis, according to the Basel Committee, is that material losses in one systemically important financial institution (SIFI) can trigger concerns about the solvency of other SIFIs, with potentially catastrophic consequences for global financial stability.

The committee said it is of the view that the large exposures framework is a tool that could be used to mitigate the risk of contagion between global systemically important banks, thus underpinning financial stability.

SEC resolves rebate rate plea

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In the 1995 case of Norwest Bank Minnesota, the SEC permitted an affiliated custodian to receive compensation for providing certain services as a lending agent. This decision allows a fund's investment adviser to delegate to the securities lending agent the task of entering into loans with pre-approved borrowers on pre-approved terms.

In its own application letter to the SEC, Nuveen stated that it is generally not practical for the bank, in its capacity as securities lending agent, to submit the rebate rates to the adviser for pre-approval as required under the Norwest decision, and that it is not industry practice to do so.

Nuveen argued that pre-approval of the rebate rates from the adviser is not needed to protect the funds' shareholders due to the protections afforded by securities lending procedures that have been put in place to ensure that the rebate rates are being set by the custodian in line with prevailing market conditions, according to Ropes & Gray.

The SEC indicated that it generally agreed with Nuveen's position and granted the relief requested, subject to the conditions described in the Nuveen no-action letter. In addition, SEC staff affirmed its view that relief from Section 17(e)(1) of the 1940 Act is "inappropriate" when

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the lending agent retains full discretion to negotiate loan terms.

Collateral dipped in 2013, finds ISDA

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Cash and government securities accounted for roughly 90 percent of non-cleared OTC derivatives collateral.

The 2014 Margin Survey also demonstrated that portfolio reconciliation is widely used and considered a best market practice, according to ISDA. Larger-sized portfolios (100-499 trades) showed a 5 percent increase in daily reconciliation at the end of 2013 compared to 2012.

Eighty-four percent of large firms surveyed indicated they reconcile their portfolio mix on a daily basis.

“Collateralisation has a fundamentally important role to play in risk mitigation,” said Robert Pickel, CEO of ISDA.

“Over the past 14 years, ISDA’s Margin Survey has provided a consistent set of benchmarks for collateral use and is part of a broader set of the association’s initiatives in the area of collateral, including documentation, best practices and practitioner guidelines.”

Banks, broker-dealers, asset managers, hedge funds and insurance companies were among those that responded to the survey.

Dutch pension funds, take note

To help its Dutch pension fund clients meet the Financieel ToetsingsKader (FTK) regulations set out by the Dutch National Bank, Northern Trust has enhanced its investment statement reporting solutions.

The enhanced solution, designed in line with the Dutch National Bank guidelines, offers valuation data, cash-flow modelling and shock testing analysis to help pension funds demonstrate appropriate investment scrutiny, data integrity, and risk modelling as their investment process evolves.

Under the FTK regulation, Dutch pension funds are required to demonstrate a transparent approach to managing their assets and liabilities, in line with their investment decisions, in order to gauge sensitivity to market shocks and the impact this will have on pension scheme members.

“For many Dutch pension schemes focusing increasingly on liability driven investments and alternatives, these new requirements present a number of challenges,” said Frans Hofkens of the institutional investor group at Northern Trust in the Netherlands.

“By using a consistent suite of cash-flow modelling assumptions and performance calculations, Northern Trust can deliver timely data and reporting to our clients, helping them meet their regulatory requirements.”

Northern Trust’s tailored solution for Dutch clients includes quarterly and annual statements, as required under the FTK regulation, as well as cash flows and prescribed shock tests at the asset level to provide exposure reporting.

This can be broken down by asset class and risk currency versus strategic benchmarks, looking through pooled investments to underlying assets, effective exposure on all derivative types, and performance and contribution reporting for each asset class.

"Northern Trust's solution models every market risk by asset type—from commodity investments to interest rate sensitivities," said Simon Willcox, global head of performance product management at Northern Trust.

"We understand Dutch pension funds have unique regulatory challenges and by leveraging expertise from across our investment risk and analytics team, we can offer a fully integrated performance, risk and regulatory reporting suite of capabilities tailored to their specific requirements."

Most recently, Northern Trust enhanced its collateral management and liquidity solutions in order to help clients meet the requirements of implementing various regulations, such as the US Dodd-Frank Act and European Market Infrastructure Regulation.

Hedge fund forward redemptions dip in April

The SS&C GlobeOp Forward Redemption Indicator for April measured 3.23 percent, down from 3.81 percent in March.

"April redemption activity decreased slightly from March, but remains in line with historical averages," said Bill Stone, chairman and CEO of SS&C Technologies.

The SS&C GlobeOp Forward Redemption Indicator represents the sum of forward redemption notices received from investors in hedge funds administered by SS&C GlobeOp on its platform, divided by the AUA at the beginning of the month for SS&C GlobeOp fund administration clients on the GlobeOp platform.

Forward redemptions as a percentage of SS&C GlobeOp's AUA on the GlobeOp platform have trended significantly lower since reaching a high of 19.27 percent in November 2008. The next publication date is 21 May 2014.

Institutions look to the open range

Official institutions are looking to new markets and a broader range of assets as they search for greater returns, according to a new report by State Street.

In New Horizons for Official Institutions, more than 60 senior executives at official institutions, defined as central banks, sovereign wealth funds (SWF) and public pension reserve funds, were surveyed to explore the opportunities and challenges they face today and in the future.

Despite concerns about the challenges associated with new markets and asset types, 80 percent of official institutions surveyed expect to increase their exposure to new markets, and, where they have the appropriate mandate, to alternative assets such as hedge funds, private equity, real estate and infrastructure.

This move into new asset types is creating new levels of portfolio complexity and within this uncharted territory are fresh challenges, said the report.

Among those surveyed, 51 percent said that the biggest challenge is correctly measuring and monitoring the amount of currency risk they are taking.

This emerged as the biggest concern for Asia Pacific and China respondents with 44 percent saying it is a challenge to combine different risk measures across asset classes.

Other hurdles cited were higher interest rates, emerging market volatility, and the rising cost of execution, given collateral issues and additional reporting requirements.

"Official institutions are at different stages in terms of how and where they can invest,

but it is clear that those institutions with a more flexible investment mandate are recalculating their approach and looking to new markets and asset classes as they search for yield," said Joe Antonellis, vice chairman of State Street.

"The resulting portfolio diversity presents fresh challenges, and official institutions will need the right teams and supporting solutions to manage these strategies."

Official institutions need to measure the moving targets of risk, complexity and efficiency and be more adaptable than ever.

Overall, managing risk was the biggest challenge for survey respondents, with market risk cited as a major concern for 86 percent and operational risk just behind at 73 percent. But confronting these risks requires greater investment.

Almost two thirds of respondents (60 percent) plan to increase investment in their risk management systems and processes over the next two years, and 32 percent of respondents reported difficulties hiring employees with risk, compliance and reporting skills.

"To meet the challenges identified in this research, official institutions must create an efficient, streamlined, yet resilient, operating model," said Rod Ringrow, senior managing director at State Street.

"This means reducing costs while not compromising on standards, finding the right combination of people, process and technology to support investment needs and operational challenges, and using data to generate insights that support better-informed investment decisions."

"Across all these areas, institutions must retain the necessary rigour in their decision-making and remain truly accountable under ever-greater scrutiny."

Life Partners takes on fake stocks

Life Partners Holdings has filed a lawsuit against optionsXpress, a subsidiary of The Charles Schwab Corporation, the company's chief financial officer, and one of the company's largest customers, for allegedly issuing and selling counterfeit shares of Life Partners Holdings stock.

The lawsuit, filed in Illinois by California attorney Gary Aguirre, whose practice focuses on market manipulation, asked the court for an order preventing the Schwab subsidiary from creating and selling shares of Life Partners Holdings's stock which were not authorised by the company.

The action also asks the court for protection from securities fraud, deceptive business practices and civil conspiracy arising from the unlawful issuance of the counterfeit shares.

The lawsuit is based on findings from an administrative proceeding conducted by the US Securities and Exchange Commission against optionsXpress and the other defendants, which concluded that they committed securities fraud when they engaged in the sales of "counterfeit-phantom stock" passed off as the genuine stock of 25 public companies, including almost $5.5 million of counterfeit-phantom stock of Life Partners Holdings Inc.

Life Partners Holdings CEO Brian Pardo commented: "This case isn't about money. It's about confidence in the market. It's about making sure that, in the future, shareholders can be sure that they are purchasing legitimate, authorised stock."

"Individual investors need to know that the stock they are buying is real and not phantom stock cooked up by Wall Street insiders."

"Without a stock certificate, we've seen how easy it is for Wall Street to pass off counterfeit stock in your account as legitimate and we want to put a stop to it."

The company is continuing to investigate other persons and entities that may have engaged in counterfeiting shares of Life Partners Holdings.

Collateral efficiency will drive capital

Netting efficiency, default fund structure and collateral efficiency are core drivers for capital efficiency, according to Eurex Clearing.

In its study, The Future of Central Clearing, the European clearinghouse sought to discover how new capital and collateral requirements affect derivatives and securities financing markets.

The analysis showed that sell- and buy-side participants can substantially lower their capital and funding costs by actively pooling clearing business on an integrated cross-product central counterparty (CCP).

Besides achieving savings from cross-margining OTC and listed derivatives, significant efficiencies may be realised from cross-product exposure netting, an integrated default fund structure and collateral management services.

"The decision how to optimally allocate exposures across CCPs is the critical driver for sell- and buy-side participants in order to maximise efficiencies," said Matthias Graulich, chief client officer of Eurex Clearing.

"Our analysis provides for the first time a full in-depth quantification from the perspective of a market participant. The results show that Eurex Clearing's approach to create an integrated cross-product offering allows substantial cost savings."

New regulations to strengthen the safety and resilience of financial markets such as Basel III or Capital Requirements Directive IV (CRD IV) are increasing capital and collateral requirements for derivatives and securities financing transactions.

The study includes detailed case studies for typical portfolios of a global and a regional bank, as well as for a mutual and a hedge fund, and quantifies the cost components for interest rate derivatives, repo and securities lending exposures.

For these asset classes, an integrated cross-product CCP structure with a broad collateral spectrum can deliver up to €4 to €5 billion incremental cost benefits to the European sell-and buy-sides.

Eurex Clearing is a hub for euro-denominated equity as well as interest rate derivatives offering CCP services for interest rate swaps, bund, bobl, schatz and euribor futures, as well as repo and securities lending transactions in an integrated clearing model.

Starting on 26 May, Eurex Clearing will launch the second release of Eurex Clearing Prisma, the new portfolio based risk management system, allowing cross-margining of OTC and listed fixed-income derivatives.

Citco sells up Cork business to Clearstream

Citco has sold its Irish hedge fund custody processing business to Clearstream.

The price was withheld, but was said to be in the mid-double digit million euro range.

The deal allows Clearstream to significantly expand its hedge fund services for financial institutions while enabling Citco to strategically focus on its core fund investor client base—namely fund of hedge funds, family offices, insurance companies and pension and endowment schemes—via its alternative investor services division.

The acquisition of Citco Global Securities Services's (CGSS) hedge fund custody infrastructure adds around 300 CGSS employees based in Cork to Clearstream and licenses Clearstream to use Citco's custody IT infrastructure.

The two companies will ensure the takeover takes place in a gradual way in order to ensure a smooth transition.

Philippe Seyll, member of the executive board and head of investment funds services at Clearstream, said: "The additional business of Citco Global Securities Services's hedge fund custody operation enables us to fast-track our standardisation and automation initiatives in the hedge funds industry and to offer our financial institution customers a superior value proposition."

"The know-how and expertise in hedge funds operations we acquire from Citco combined with our operational excellence in mutual funds will enable our Vestima platform to become the leading international fund market infrastructure for all types of funds."

William Keunen, global head of Citco's asset servicing business, said: "We are delighted to be able to offer our financial institution clients the opportunity to combine Citco's capabilities in the alternative sector, together with Clearstream's existing fund platform for a true one-stop-shop fund processing product."

"Citco's alternative investor services division will continue to focus on its core business of providing a full suite of asset related services to our core fund investor client base that allocate to alternative asset classes."

State Street enjoys Q1 2014 securities finance increase

State Street earned $85 million in revenue from securities finance in Q1 2014, an 11.8 percent increase on the last quarter in 2013, thanks to new custody mandates.

The increase, primarily due to higher spreads and volumes, was also 9 percent higher than Q1 2013, primarily due to new business in enhanced custody.

New asset servicing mandates during Q1 2014 totalled $189 billion and net new assets to be managed were $4 billion.

Meanwhile, servicing fees of $1.24 billion in Q1 2014 increased 0.5 percent from the final quarter of 2013, primarily due to stronger global equity markets and net new business, although they were partially offset by lower transaction-related revenue.

Compared to Q1 2013, servicing fees increased 5.4 percent, due to stronger global equity markets and net new business.

Joseph Hooley, chairman, president and CEO at State Street, said: "Delivering value to our clients and shareholders is our core mission. We remain focused on our key prioritiese—increasing revenue, controlling expenses, investing in growth opportunities, and optimising our capital structure to create long-term value."

"We are responding to the challenges presented by low interest rates and conservative investor risk appetite by realigning our staffing to support our goal of positive operating leverage for the full year."

He added: "Client demand for our products, services, and solutions remains strong. New asset servicing wins totalled $189 billion for the quarter, which included 25 new mandates in alternative investment servicing where we hold a leadership position and see additional opportunities for growth."

State Street bagged new custody mandates from Etera Mutual Pension Insurance Company and insurance company Ageas UK this year, with Afore SURA, one of the largest pension funds in Mexico, among the new clients signing up to the bank in 2013.

The bank also recruited Lou Maiuri from BNY Mellon, to take over as head of securities finance.

Nicholas Bonn, State Street's interim securities finance chief, stepped down, but continues to lead its transition management and portfolio solutions businesses.

Banking agencies adopt final ratio

The Federal Reserve, Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency have adopted a final rule to strengthen the leverage ratio standards for the largest, most interconnected US banks.

The final rule, which becomes effective on 1 January 2018, applies to US top-tier bank holding companies with more than $700 billion in consolidated total assets or more than $10 trillion in assets under custody (covered BHCs) and their insured depository institution (IDI) subsidiaries.

Under the final supplementary leverage ratio, covered BHCs must maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3 percent, for a total of more than 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments.

IDI subsidiaries of covered BHCs must maintain at least a 6 percent supplementary leverage ratio to be considered 'well capitalised' under the agencies' prompt corrective action framework.

The final rule currently applies to eight large US banks that meet the size thresholds and their IDI subsidiaries.

The final rule is substantively the same as the rule proposed by the US banking agencies in July 2013.

In a statement, Federal Reserve board of governors chair Janet Yellen commented: "The financial crisis showed that some financial companies had grown so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability."

"[This] action is another step in the Federal Reserve's efforts to address those risks."

"The final rule … would implement enhanced supplementary leverage ratio standards for the largest and most systemic US [banks]."

"Under this framework, these banking organisations would have to hold substantially in-

A focus on regulation

Clearing the way for profit

OTC derivatives reform on both sides of the Atlantic has caused industry upheaval, with market participants scrambling to ensure that they are fully compliant with all relevant rules and regulations ahead of the various deadlines. However, compliance comes at a cost, and many firms have found it difficult to justify the required investment in new systems and processes and/or have struggled to find ways to keep business lines profitable in the new world. In particular, mandatory clearing, as stipulated by the US Dodd-Frank Act and the European Market Infrastructure Regulation (EMIR), has caused concern.

A key challenge for the sell side is how to make a profit from client clearing. Customers expect clearing services to be provided at little or no cost as part of the broader client relationship, leaving only 'value added' services to provide fee earning opportunities. This has been the established exchange-traded model. The next two years will establish the winners: those banks with the broadest, most flexible services combined with cost leadership. This requires substantial investment in technology and automation that not all can afford, so we anticipate shifts in the industry as some players withdraw from markets they can't make money in, to focus scarce investment on their core franchise.

Yet there is money to be made in the industry. Clearinghouses have long recognised that there are substantial revenue streams to be made—not just from clearing fees but from the re-investment of collateral held on behalf of members. It is likely that new regulations may cause some realignment in the clearing industry. Historically, while many exchanges cleared cash instruments themselves, OTC clearing was often outsourced to established clearinghouses.

However, in recent times we have seen NYSE Liffe and LME terminate their outsource arrangements with LCH.Clearnet to establish their own clearing facilities. Last year, the London Stock Exchange took a majority stake in LCH.Clearnet, further accelerating the emergence of the vertical clearing model in which exchanges and clearing are integrated by asset class. Meanwhile, new European clearinghouses such as CME Europe are being established in anticipation of mandatory clearing. Nobody knows whether all central counterparties (CCPs) will survive in all the asset classes that they are preparing to clear, but we can be sure that the shape of the industry will evolve in the coming years.

Innovation is also underway in the traditionally slow moving world of custody and securities depositories. Article 47.3 of EMIR prevents clearinghouses from holding their assets at custodians, forcing them instead to hold their assets at securities settlement systems, more usually known as central securities depositories (CSDs). This poses a threat to custodians that do not operate CSDs, as buy-side clients will have little choice but to move assets they are using to margin OTC business to venues that are more convenient for CCP collateral allocation.

The major beneficiaries of this regulation are likely to be firms that are both custodian and securities settlement system, such as the international CSDs Euroclear and Clearstream. Other custodians are also making strategic moves to position themselves for this new environment and further delays in the implementation of regulations could enable them to erode the competitive advantage of the established providers. For example, BNY Mellon has decided to launch its own CSD in Belgium, while J.P. Morgan is partnering the London Stock Exchange, itself setting up a new CSD in Luxembourg based on its Monte Titoli infrastructure.

We will of course see further changes in European CSD infrastructure as participants gear up in 2014 for the advent of T2S in 2015, which promises radical restructuring and cost reduction for cross-border securities settlement.

David Field
Executive director
Rule Financial

creased levels of high-quality capital as a percentage of their total on- and off-balance sheet exposures to avoid restrictions on capital distributions and discretionary bonus payments."

"Thus, the framework provides incentives to such firms to maintain capital well above regulatory minimums."

Testing technology essential, says SunGard

A survey undertaken by SunGard Consulting Services has revealed concerns that the testing of day-to-day financial services systems is insufficient to protect against failure.

SunGard's research has found that the smooth implementation of upgrades or new technology is crucial in helping to ensure that financial services firms can offer new or improved products and services to their customers and retain a competitive advantage.

Failure to properly test technology could result in outages and downtime that may lose the firm business and cause reputational damage.

Cost represented the single biggest challenge for survey respondents, followed by insufficient time to meet deadlines, incomplete or ambiguous requirements, and insufficient resources.

For 23 percent of respondents, the cost of testing exceeded a quarter of a project's entire budget.

Nearly three in five respondents said that budget restrictions impeded the improvement of the testing process system.

Of the regulations driving increased focus on system testing, Basel III is the most prominent.

Forty percent of those who saw regulations as a driver cited this international standard as boosting the need for improved system testing.

Aside from general banking requirements, local regulations were the next strongest drivers, including the Single Euro Payments Area (SEPA), US Foreign Account Tax Compliance Act (FATCA) and the Consumer Protection Code.

Michael O'Connor, project manager for information systems and development at ACCBank, commented: "Impending regulatory deadlines, such as SEPA in the EU, present a number of challenges to firms to be in compliance."

"Having a smoothly operating technology infrastructure is crucial to satisfy both regulators and clients."

"Engaging SunGard to assist us in the testing of our systems ahead of the SEPA deadline has meant that we can be confident that we will meet the needs of both on an ongoing basis."

A borderless time

The stability of the Canadian securities borrowing and lending market has given domestic players the confidence to conduct cross-border business

MARK DUGDALE REPORTS

The likes of CIBC Mellon and Scotiabank—two of the bigger Canadian outfits—have boosted their cross-border capabilities in recent years, signalling to the wider world that they are global players in securities borrowing and lending.

For example, Scotiabank's prime services division has securities lending desks in London, New York and Singapore, and it boasts the financing of US convertible bonds in its product offering. In 2011, the bank acquired a synthetic prime brokerage platform and team from Daiwa, further enhancing its prime brokerage capabilities.

James Treseler, managing director at Societe Generale Corporate & Investment Banking, says: "Why are Canadian banks so attractive outside of Canada? Everyone loves Canadian balance sheets—they're conservative, and very liquid. During the banking crisis, no Canadian banks were affected."

"As we've seen more and more regulation in the US and Europe, it's forcing some of the larger players on both sides, of the market—whether it be in agency lending side or prime services—to scale back some of their activities. There's market share available to Canadians. I think they see that as global market share."

Canadian banks are moving into Europe, South America and Asia, says Treseler, but how are securities lending heads convincing their bosses to set up desks?

"If I was them, I'd be pointing at the market share that is available to us," explains Treseler. "If I have a prime services group, that means I have to be able to cover European underlying, which in turn means that I have to be in Europe." "You can be in Hong Kong and cover Australia, but you cannot cover Europe from Toronto, in the same way that you cannot cover the US if you're in London—you're just not in the market."

Europe in particular has always been an important source of demand and revenue for Canadian beneficial owners, says Rob Ferguson, who is president of the Canadian Securities Lending Association and senior vice president of capital markets at CIBC Mellon. He adds that "demand for the securities belonging to Canadian owners is always strong".

"In the last couple of years, the demand has fallen off a bit, and the size has dropped somewhat. In terms of whether it is becoming more important, I would say probably not. But you always have to look and see whether having a local presence is going to generate more opportunities and revenue for your programme participants, and sometimes that answer is going to be yes—even when that market isn't at its highest."

In October last year, CIBC Mellon and BNY Mellon announced they were merging their securities lending desks, a move that would give the former's clients new opportunities for incremental revenue in markets around the world and the latter's clients the potential for improved returns on Canadian securities.

Commenting on the merger last year, Ferguson said: "[BNY Mellon's global head of securities finance] James Slater and I began talking a few years ago. We discussed the challenges and the market, and realised we had a unique opportunity here in that our programme, which has been very successful since the beginning, had one desk, in Toronto. We had people who would come in early in the day to cover the European time zone, but there was some limitation around servicing the world out of just Toronto."

"James's group is significantly bigger, and has desks in Hong Kong, London, New York and Pittsburgh, but BNY Mellon doesn't have a desk in Toronto. Canada is a very large and important market in securities lending and James saw an opportunity for BNY Mellon clients to be better served in the Canadian market."

Ferguson explains: "The continued importance of cross-border demand was in fact a key aspect of our decision to merge CIBC Mellon's lending desk with BNY Mellon's."

"We did a very good job of lending European securities for our beneficial owners prior to the merger, but having the BNY Mellon local presence has made it easier for us to do that and resulted in more opportunities."

"I think people are generally going to look and say, 'what is the size and cost of the opportunity', weigh that against the relevant risk factors, and go from there; having a strong local presence can in some cases put you in a good position to gain insight into both opportunity and risk factors."

Concluding, Ferguson says that Canada has enjoyed a period of relative strength and stability.

"We as much as anybody else in other jurisdiction, are focused on finding efficiencies and making sure that we are managing risk appropriately. We are in a good position to realise some opportunities without some of the pressures that other jurisdictions may have." **SLT**

The sycamore of securities lending

CASLA president Rob Ferguson and Societe Generale managing director James Treseler on why the Canadian market continues to go from strength to strength

CASLA PREVIEW

What will be the theme of this year's CASLA conference?

Rob Ferguson: This year's Canadian Securities Lending Association (CASLA) Conference on Securities Lending will have a familiar theme, around regulatory change and its effect on securities lending.

So regulations such as Basel III and the US Dodd-Frank Act, and the knock-on effects, including the importance of collateral, and balance sheet and collateral management concerns.

We are going to follow the same sort of agenda that we have in the past—we have an equity panel, a fixed income panel, and speakers representing hedge funds.

But the cornerstone of the conference will undoubtedly be the regulatory session.

How important is the conference to securities lending professionals?

James Treseler: The Canadian Securities Lending Association Conference is an important conference for the teams, mostly for networking.

People forget what a huge place Canada is and how hard it is to get around—especially when winter lasts for 10 months of the year.

How would you describe the Canadian securities finance market?

Treseler: The Canadian market is quite robust, and it would look far more significant if it wasn't next door to the US market.

It's like having a sycamore tree next to a large oak. The sycamore gets lost because the oak tree is in front of it.

Canada is a rather significant markeplace in securities finance.

Ferguson: The Canadian market remains very strong, with healthy demand, particularly on the fixed income side.

From what we have seen in the markets, while Canada is still a predominantly non-cash collateral market, the interest in and acceptance of cash as collateral continues—particularly on the agency lending side.

On the equity side, I would say that the market has been unspectacular.

I think the demand has been good and consistent, but is mostly general collateral demand—there haven't been many specials.

Treseler: The Canadian markets are also slow to open up to various forms of collateral, which I think is a healthy thing for the market.

We are also seeing different strategies employed and reinvestments, which are allowing some players to take something more than dollars, and we need that type of flexibility.

What we're seeing more and more in the Canadian market is the experience of Canadian players outside of Canada.

What about the ETF industry?

Ferguson: The exchange-traded fund (ETF) industry has been one of the bright spots in Canada.

There was a change in the Canadian regulations last year that expanded the ETF market by allowing all exchange-traded assets to be lent, so that has increased demand.

Besides that, there haven't been substantial changes in regulations coming out of Canada—the impacts have really come more from the US and some of the European regulatory and tax changes, and their effects on us.

Those are what have been keeping Canadians busy.

Treseler: Globally, you're seeing improvement in market demand for exchange-traded funds, but it's quite slow outside of the US.

The US has an enormous market, mostly because of the retail supply in the market. We're seeing some growth, but it's extremely slow.

Finally, how has the merger of CIBC Mellon's and BNY Mellon's securities lending operations been going?

Ferguson: The merger has gone exceptionally well. We have worked very closely with BNY Mellon for many years, including in our securities lending programmes.

We were already working together from a marketing and product perspective, and even shared our systems. I expected that even though it was a very big project that it would go smoothly, but even so, I have been pleasantly surprised at how seamless the transition has been.

We've always used BNY Mellon's core custody system, but the securities lending system, we have the same version but separate instances, and we have merged to one instance.

This was a big job, and there was a lot of work that had to be done on that. We had a lot of static information—thousands of records—that needed to be updated, including client information on limits and restrictions, down to specific security restrictions for specific clients.

All of those had to be reproduced in the target system, and vetted and tested. **SLT**

Rob Ferguson
President
CASLA

James Treseler
Managing director
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The more things change, the more Canada stays the same

Panellists discuss how global regulatory upheaval is causing more concern than changes closer to home

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Vice president, sales
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Northern Trust

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How would you describe the start to 2014 for the Canadian securities lending market and how do you think the year will shape up?

Timothy Smith: A cursory glance at the statistics shows a sort of flat, even keeled business environment for securities lending levels. It could be argued that Canada, while not being affected as badly as other markets during the financial crisis, does not have the same boom and bust or seasonal-type characteristics of emerging and European markets.

Looking below the surface, however, there are some trends visible and of interest. For example, corporate bond activity has fluctuated down by 25 percent in January, but then balances have increased more than that amount since. Equity borrowing has increased by a significant 30 percent, which could be the impact of commodities interest and overall rise in the Canadian market value.

This is, however, a different story than for Australia, which has a high preponderance of commodity stocks, too.

In terms of predicting the rest of the year, too many people have lost too much money by doing so, but in terms of dealing with structural market changes, Canadian securities lending has usually been at the forefront of measured and successful response.

Dave Sedman: Supply (through a number of new mandates) and demand have remained strong in the Canadian market during the beginning of 2014. Although spreads remain on par with 2013, utilisation continues to increase to new highs. Our single global proprietary system provides our traders access to our clients' portfolios around the globe 24-hours a day, so we are able to maximise these lending opportunities for our clients.

Demand in Canadian equities has been largely driven by dividend yield enhancement trades, dividend reinvestment plan (DRIP) trades and specific directional names. The DRIP trade continues to show attractive returns and is a large driver of revenues for our clients. There have been a few specials that have contributed to a very successful start to the calendar year, too.

Charles Murray: Year to date, 2014 loan balances and fee levels in Canada have been similar to those we saw in 2013. Borrowers have shown increased interest in collateral transformation trades year over year, and particularly in equity versus equity. We expect this trend to continue, though the scale will be influenced by provisions within the US Dodd-Frank Act and Basel III that define credit exposure, risk-weighted asset calculations and capital requirements.

Phil Zywot: Overall, the Canadian market has been off to a very strong start, and we are optimistic about the year ahead. We've seen healthy developments on the mergers and acquisitions front, particularly in the resources and healthcare sectors. Secondary offerings have also been quite hot in the energy sector, with CAD$2.7 billion raised in the first quarter alone—a six-fold increase over 2012.

Canadian sovereign bonds remain in high demand owing to Canada's strong credit ratings, and we have seen record balances against both cash and non-cash collateral. IPO activity has been relatively unimpressive, however, this has been one of the slowest starts since 2001.

Alexa Lemstra: The Canadian securities lending market is consistent in terms of on-loan values, and 2014 has continued in that trend. On-loan values fluctuated 11 percent from 1 January to 1 April, with a high of $139 billion in mid-March. Fees for securities borrowed in the Canadian market came down toward the end of 2013 and have stayed flat into the beginning of 2014.

The Canadian market in 2014 will likely continue as the strong general collateral market it historically has been, maintaining consistent on-loan volumes and fees.

How will Canada's changes in requirements for short selling activities affect the industry there?

Sedman: The Investment Industry Regulatory Organization of Canada (IIROC) introduced amendments with respect to short sales and failed trades a while ago. Two of the major changes were the repeal of the tick test and the introduction of a pre-borrow requirement. IIROC repealed the restriction requiring a short sale of a security to be made at a price greater than or equal to the last sale price. Short sales will no longer be subject to the tick test.

Under the new pre-borrow amendments, a participant is required to locate a lender where the security may be borrowed before entering a short sale of: any listed security on behalf of a client that previously had an extended fail for 13 consecutive days, any listed security on behalf of the firm if the firm had an extended fail for 13 consecutive days, or any security that IIROC designates as a 'pre-borrow security'. If any of these conditions exist, a locate requirement will be required. These changes have not had any material impacts on our securities lending business.

Zywot: Canadian regulators and participants recognise the role that short selling plays in the markets in terms of efficiency, price discovery and hedging strategies. Most of the regulatory impacts to Canadian participants are in fact from global regulation, for example, a financial transaction tax has put a temporary damper on demand from Europe.

Murray: We've seen very little impact on the industry. The repeal of the tick test, the use of the 'short exempt' designation, pre-borrow requirements and increased regulatory reporting have neither increased nor decreased short activity. Borrowers' and their clients' various trading strategies continue to drive lending needs.

Smith: Canada is not alone in seeking to obtain a better understanding and more transparency and reporting around short selling and securities lending activities. An early warning reporting regime and other methods are all aimed at making sure that regulators are as up to date in their thinking as the other market participants.

It is a basic tenet, however, that when regulators meddle with the market in order to prevent wild swings one way or the other, this tends to have the opposite effect. However, political factors of being seen to be doing something often prevail. Given the years of uncertainty regarding regulation we have all faced, we are probably as well placed as we ever have been for every eventuality.

Consequently, for Canada, I am still seeing and feeling a business as normal and 'we will cope' approach that has been its hallmark over the years.

What do you think appropriate collateral requirements from a risk, liquidity and efficient market perspective are?

Murray: Market participants must first consider regulatory requirements—including those to be set by the Financial Stability Board—when it comes to margins and acceptable collateral types. Each lender must also consider its individual risk appetite.

Broadly, however, the nature of risk in securities lending is that of market risk contingent on borrower default. To protect our lending programme and individual clients from potential losses after a borrower default, we—like other lending agents—implement oversight procedures to address the two major risk components, borrower credit risk and collateral (market) risk. We conduct fundamental credit analyses of all borrowers in our programme, including internal credit ratings and ongoing credit due diligence.

On the collateral risk management front, we continuously review margin levels, diversification and liquidity limits, stress tests, and other controls to mitigate potential market risk exposure.

Sedman: Northern Trust believes that securities lending is not a one-size-fits-all business. As such, we provide our clients with the opportunity to select the collateral that best fits their risk and return profile. Our securities lending team is one of the most experienced in the market and works with clients to define the lending and collateral parameters for their programmes.

While government of Canada bonds, provincials and other high quality debt continue to be the collateral of choice, clients are expanding to equities and corporate bonds as a way to diversify their collateral and increase their securities lending opportunities.

Zywot: Collateral requirements continue to evolve from both borrower and beneficial owner perspectives. Borrowers are constantly looking optimise collateral, so the greater the flexibility in terms of collateral acceptability from the agent lender and the beneficial owner, the greater the return and utilisation within securities lending.

The specific types of collateral accepted can in many cases make or break the execution of a given trade. As global regulation continues to evolve, collateral flexibility from all three participants in the loan (borrower, agent and ultimate lender) will become more important and likely more valuable.

When evaluating the collateral requirements for a given trade, the 'appropriate' requirements are that the trade makes sense for the participants from a risk-adjusted return basis, from a governance perspective and based on guidelines provided by both lenders and regulators.

In mid-2012, BNY Mellon established its global collateral services business in anticipation of changing client needs across the investments lifecycle in the face of global regulatory reform efforts. Global collateral services brings together a set of related services and capabilities including collateral management, liquidity, derivatives consulting and securities lending.

Has the trend of collateral transformation been adopted in Canada?

Zywot: It all depends on how you define collateral transformation. Certain types of collateral optimisation have a long history in the Canadian marketplace—for example, participants have been borrowing Canadian government bonds while lodging provincial government bonds for many years. Some markets in recent years have embraced the practice of lending bonds while taking equities as collateral, but Canadian market participants have always been quite conservative in terms of adopting new strategies, so I would say this activity is not as widespread here. As always, trades need to make sense from a risk-adjusted-return basis, the owners' internal guidelines for participation, and of course the guidance from regulators.

Sedman: Collateral transformation has been a part of the Canadian securities lending market for quite some time, although it has continued to evolve over the years. Collateral transformation is an important part of our programme at Northern Trust and will remain so in the future. The efficient financing of long positions continues to be a major focus for borrowers.

Since Canada is one of the last AAA-rated sovereigns, it is likely that demand will grow for Canadian government and government-backed collateral. Clients with greater flexibility and broader collateral guidelines will likely see increased loan balances and securities lending revenues.

Smith: Over the years there have been various 'phrases du jour' that have become over-used. The latest one would appear to be 'collateral transformation', which, depending upon context and intonation, appears to be used to denote an opportunity for or a dubious use of securities lending. The real truth is that as more and more regulations are imposed to require more and better quality collateral for more types of transactions, then collateral has to be 'transformed' in order to comply.

Murray: In Canada, and globally, borrowers have a renewed desire to fund different types of securities. The scope of transformation will depend on new regulations affecting all banks.

What were the effects of Canada's regulatory change in October that expanded the definition of a 'qualified security'?

Murray: The expanded definition has widened the pool of available lendable securities, creating new revenue opportunities for securities lending clients. For example, the ruling clarified the status of non-Canadian trust units as qualified securities, clearly exempting distributions from these foreign trust units from non-resident withholding tax. Including foreign exchange-traded funds (ETFs) as qualified securities has also been a positive development, given their growing use by investors.

Zywot: The expansion of the definition of "qualified securities" to include exchange-traded assets has been quite positive for the market. We've seen an increase in lendable assets and revenues for income trusts and ETFs in Canada.

Sedman: With the expansion, non-Canadian ETFs, US real estate investment trusts (REITs) and other non-Canadian trust units that are listed on a stock exchange are now included in the scope of "qualified securities". This expansion has led to increased revenue opportunities for beneficial owners as it allows us to lend these assets as well as accept them as collateral. This has led an increase in lendable base and on loan balances.

Although Canada has typically been a more conservative securities lending market, it continues to adapt and change along with the marketplace. This is another positive step in the continuing evolution of the Canadian securities lending market.

What other regulations are having an impact on the Canadian market?

Murray: Certain provisions within Dodd-Frank and Basel III are expected to have broad market impact, not just in Canada, though the size and scope remain difficult to measure. Transparency requirements, cash collateral investment guidelines and minimum haircuts for securities lending and repo transactions established by the Financial Stability Board will also play a role.

We've met with senior regulatory officials, written comment letters to the Federal Reserve and Basel Committee, and participated in meetings with industry associations, such as the Risk Management Association, to address the impact of proposed regulations on agency securities lending programmes.

Sedman: While there are a number of regulatory changes impacting the Canadian market, one of the more recent changes was IIROC's response to a request for guidance on the interim capital treatment of certain cash and securities lending arrangements. Members had requested relief for cash and securities lending arrangements where either an acceptable counterparty or a regulated entity is the counterparty to the arrangement, or where an acceptable institution agent administers a lending programme on behalf of its acceptable counterparty and regulated entity clients.

IIROC staff concluded that the risk associated with existing principal cash and securities lending arrangements involving acceptable counterparty and regulated entity clients is largely the same as agency arrangements, and that any interim capital treatment afforded to these agency agreements should also be granted to principal cash and securities lending arrangements involving acceptable counterparties and regulated entities.

As a result, many members are now able to apply the same capital treatment to collateral provided to lenders. With the growth of agency arrangements within the Canadian market, this was welcome news to Canadian participants.

Regardless of regulatory changes, the Canadian market should continue to provide investors with an attractive value proposition.

Smith: The Canadian market or rather the securities lending business in Canada is affected by the global regulatory framework changes being discussed and decided upon. As we crawl ever closer to finally getting to the end of the uncertainty, then the impact, either positive or negative, will be seen.

Zywot: Largely, recent regulatory impacts on Canada have been global, with Basel III and Dodd-Frank being major sources of change. Canadian participants are quite prudent and generally maintain very strong balance sheets well above global requirements, but banks and brokers definitely share their international peers' greater consciousness of the cost of capital and how its use can be maximised.

Perhaps the biggest factor is the ongoing uncertainty about the final state of various regulations and their impacts to Canadian participants.

In what areas of your business are you investing in the most?

Lemstra: We see our clients investing in technology systems to establish infrastructure that can address their needs for scalability, flexibility and straight-through processing. On the trading side, desks want to improve their front-end trading screens, availability feeds and streamline communication. The post-trade teams are leveraging technology for improved workflows across equities and fixed income, finding solutions for manual processes and consolidating vendor platforms.

EquiLend's focus continues to be adding value for our clients, improving our existing products and offering new services. In 2014, we have already added three new trading desks in the Canadian market, improved DataLend market data, and we are looking forward to releasing the workflow for Next Generation Trading, our project currently underway to integrate automated trading of general collateral, warm and hot securities and market data into a single, consolidated platform.

We have also been further building out our ALD (Agency Lender Disclosure) offering following increased demand from clients on the regulatory side. We are also achieving client take up in new markets such as South Africa and exploring opportunities in Latin American markets, such as Brazil.

Murray: Pending and proposed regulations necessitate, either directly or indirectly, investment in all of those areas. We must invest in technology to make sure our securities finance program continues to operate within the requirements of multiple regulatory regimes.

We're also actively considering practices that may diminish the impact of proposed regulations, including optimising revenue to credit usage; diversifying borrowers; continuing to develop new routes to market; and investigating potential new lending markets in Asia, Europe and the Americas.

Sedman: Northern Trust continues to make a number of enhancements to our securities lending programme. This includes the expansion of new collateral types, such as Canadian federal agencies and mortgage-backed bonds, new borrowers, enhancements in reporting and technology to provide clients with transparency in their securities lending programme, and programme updates due to regulatory and tax changes. Northern Trust continually invests in its technology to ensure that it is at the forefront of automation and execution.

Smith: From Sungard's perspective—all of the above. As has been the case over the last 30 years in securities finance, you cannot stand still. There is a definite linkage between all categories, which means that it is not possible to concentrate on a single driver. New regulation creates the need for new more frequent reporting and the spreading of risks among more and different counterparties and to seek more opportunities in new markets. **SLT**

Live and let fly

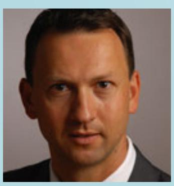
Panellists discuss progress in Eurex Clearing's Lending CCP, and what flow is expected in 2014

Michael Cyrus
Head of short term products
DekaBank

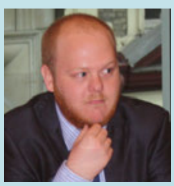
Walter Kraushaar
Global head of treasury and securities finance
Maple Bank

Frank Gast
Managing director and head of sales and marketing
EurexRepo

Thomas Wißbach
Senior vice president and clearing product design
Eurex Clearing



Markus Büttner
CEO
Comyno



Mark Dugdale
Editor
Securities Lending Times

What has been happening with the Eurex Lending CCP in the last 12 months?

Markus Büttner: A lot has happened behind the scenes here. After we helped our first clients to go live with the service at the beginning of 2013, discussions with other banks evolved from mandates to evaluation of their business case, to detailed specification work and connection to the service. In short, the first question asked is no longer 'should we'; it has become, 'how can we'.

For existing clients, we have performed the adaptations for the new services offered, ie, introduction of fixed income instruments and ESES (French, Dutch and Belgian) equities, as well as Eurex Repo's securities lending market as a new electronic marketplace.

Frank Gast: We at Eurex Repo have focused on providing our securities lending market in time, which we technically integrated earlier in 2013. Again, with the support of DekaBank and Maple, we are proud to announce that the first trades have successfully been executed in our securities lending market and passed the Lending CCP in production.

Thomas Wißbach: Eurex Clearing has developed the service further over the past year: new markets, new assets classes, new asset servicing capabilities and new flow providers have all been introduced to the Lending CCP service to offer an even more efficient and cost effective service available to our members.

Walter Kraushaar: We were always supportive of the Eurex Clearing's Lending CCP product, as we firmly believe that this market segment will become extremely important in the light of the required implementation of the new Basel III rules. It will become essential for most of the market participants to have access to central counterparty platforms in general. We expect a substantial shift of liquidity through the Eurex platform and we wanted to be among the first participants, because we had a unique chance to provide input into the product and make it compatible with our existing platforms from the very first day.

Michael Cyrus: As an early adopter, we appreciate the enhancements to the service, and also the opportunity to use Eurex Repo's securities lending market to access it. While we would love to see volumes increasing at a faster pace we are also getting signals from our counterparties that they are looking into the Lending CCP business opportunity with great interest. For DekaBank, using Eurex Repo's securities lending market as an additional platform was a logical conclusion after using Eurex Repo services for many years. Eurex Repo was already integrated and our internal lending CCP processes established. We expect that via Eurex Repo's securities lending market, more existing trading counterparts will join the Lending CCP environment.

Capital efficiency is perceived to be one of the major pros in the Lending CCP. Is it even possible to calculate this advantage pre-trade and how it relates to the cost?

Cyrus: The regulatory landscape is still fluid, rather than being a solid block, so you can measure and calculate with precision. Balance sheet, liquidity and capital are being repriced in the current regulatory overhaul. Now, these three factors happen to be the primary resources of any financing business and, as a consequence, will have a huge impact on the business of collateral trading and collateral transformation. Each bank is currently in the process of addressing this regulatory pricing conundrum, and it is advisable to invest into a strategic setting that will ensure you will not be caught out by the re-pricing of collateral transformation.

Collateral optimisation in the future will not just be an internal exercise, it will be about platform optimisation as well, and it is here, where the Lending CCP will certainly play its part.

Wißbach: Although there are many complex factors that are required to be taken into consideration to even begin this analysis, and many of these factors are different for each participant, Eurex Clearing has been able to clearly break down the significantly reduced capital costs that are available to our clearing members if they were to use the Lending CCP for a portion of their existing securities lending transactions. The Lending CCP certainly contributes to a more efficient and cost effective way to manage regulatory capital and associated costs.

Kraushaar: CCPs are one tool for managing capital, balance sheet, liquidity and collateral more efficiently. However, there are many more regulatory changes to come such as the liquidity coverage ratio (LCR), which requires a much broader view on the general business strategy of a bank. For many current businesses, it is not attractive or even possible for them to be in line with all the new regulatory changes starting in 2015. To only look at CPP platforms is not enough to manage the liquidity of a bank in a professional way.

Büttner: For all of our clients, this is a question to be answered, but how easy it is to find the answer is very different. First of all, you would have to take all advantages that the CCP brings to a trade into consideration, and weigh it up with an equal bilateral trade.

Pros such as exposure netting, operational support during the lifecycle, and settlement might be equally hard to number exactly, but are an important part of the equation. Some institutions we are consulting in this matter have made good progress in allocating cost and benefits to the respective business units, while others are in the middle of implementing such processes.

Gast: In addition to the advantages of the Lending CCP, EurexRepo's securities lending market brings additional benefits. For example, all our existing repo customers now have the opportunity to join the securities lending market without changes in the technical infrastructure, thereby realising synergies between our different funding and financing markets, ie, addition sources for loan and collateral with positive balance sheet impacts in a regulatory friendly environment.

Eurex Clearing's Lending CCP is also supporting the agency lending model. What's your view on the adoption of this in the market?

Gast: Our securities lending market has recently been enhanced with an agency model and will further attract new target groups such as funds, insurance companies and asset managers, which so far have not been able to participate in our interbank repo markets.

Cyrus: Agency lending offers a couple of characteristics that will be interesting from a collateral trading perspective in the new regulatory world. Market participants who are looking into the most efficient set up with regard to the costs of credit line utilisation, leverage ratio or capital utilisation—just to name a few—will certainly have to look into agency lending as a further instrument to achieve their goals.

Consequently, we will have a closer look in 2014 as to whether the CCP is something we would want to offer to our beneficial owners in the short term. But of course, this will certainly also depend on the benefits the beneficial owners see for themselves.

Kraushaar: The agency lending business in general is another important product to optimise the trading of collateral from a regulatory point of view. Many of the existing agent lenders are already working on a solution to combine a CCP platform with their existing product. Beneficial owners are also heavily affected by the new regulations, and they will definitely have to adopt the connection to a CCP to their lending platforms in order to keep their balances with borrowers stable. There are already projects up and running to also integrate triparty agents into this process, to offer an even more competitive product to the market.

Büttner: We are driving both topics at the same time for some of our customers, with the CCP and agency lending being seen as an answer to requirements arising from the current regulations. The specific lender license offered to beneficial owners definitely lowers the entry barrier for them to join the CCP, allowing them to participate without having to post margin. The discussions about the future of indemnification and whether a lending CCP would have the potential to replace this guarantee is certainly key, which is why we bring agent lenders and their beneficial owners together within our mandates to find answers to this paramount issue.

Wißbach: By introducing this innovative structure that allows agent lenders' customers to remain in their current principal role and still continue to use the expertise and infrastructure of an agent lender, the Lending CCP creates the ability for all securities lending participants to broaden their range of trading counterparts, thus simplifying the counterparty credit structure, minimising credit lines and above all, mitigating risk. This is a main driver that makes central clearing attractive for this market.

What do you expect for 2014 to happen with lending CCPs?

Kraushaar: We will clearly see a big shift of business from a bilateral basis into CCPs. This has already begun, as all the banks have to prepare their business for a new regulatory world, which will begin in 2015. The speed, however, will be dependent on the products a CCP can offer, ie, what kind of securities can be traded through a CCP, how competitive are the margin requirements, etc. CCPs now have the chance to usurp rivals by becoming more responsive to market participants needs and regulatory requirements. I am convinced that the Eurex Clearing Lending CCP product has a good chance to gain significant market share quickly.

Gast: Having done a lot of ground work in 2013, we feel confident in expanding our business with the integration to Eurex Clearing's Lending CCP service. Our existing client base already has demands for the connectivity options and models offered. This also means a more harmonised cross-market and cross-product service offering going forward.

Wißbach: We have seen a firm shift in opinion; large-scale borrowers and lenders now need to realise the opportunities that are available. We shall see this trend continue this year, when there will be increased levels of activity at the banks that are signing up to the service. These early adopters will benefit. Big advantages will accrue to the agent lenders from the borrowers that get involved now.

Cyrus: We certainly believe that the commitment we and other institutions have put into the service as first movers has been important to overcome the 'chicken and egg' situation any new service in our industry faces. However, CCPs are a large part of the future world. The benefits in terms of netting, credit exposure and capital are for real and will become more pronounced as the regulatory steamboat picks up pace. We expect serious business.

Büttner: As a strategic advisor we already have new assignments in 2014 to neutrally evaluate with our customers the most efficient way to connect to the service. With new flow providers at the horizon, it is not only a technical question as to which one to choose, but more a process on the business side. Within this year, Comyno will furthermore launch a bundled advisory and software package to significantly shorten the onboarding time, as we firmly believe that a wave of new memberships is approaching.

The nice thing about being a firm with the unique competence in this field is that we are actively contacted and asked for help by the potential participants. I am looking forward to the rest of this year, and I'm convinced that we have put Comyno into a position to significantly contribute to the success of our customers in this market. SLT

Canada and the world of securities finance

Chris Benedict, vice president of DataLend, highlights the state of the equity securities finance industry in Canada and how it compares to other jurisdictions

With $88 billion of equities on loan at year-end 2013, Canada held 10 percent of the global market share—which made it the second-largest securities lending market in the world by equity on-loan value behind only the US, which had $498 billion (59 percent market share). That placed Canada ahead of other major securities finance markets such as Germany, France, the UK and Japan.

Canada's equity securities finance story is largely one of stability, not unlike its equities markets overall of late. On-loan values have been on a gradual rise for some time, rising alongside the S&P/TSX Composite Index, but also partly due to new entrants in the securities lending market and beneficial owners returning to securities lending following the financial crisis. Canada's economic stability is a key factor in that.

Despite its considerable volumes, fees to borrow Canadian equities, on average, tend to trail other markets. When compared to the US, Europe, and the Far East and Australia Pacific from the start of 2013 through Q1 2014, Canadian equities have traded at the lowest fees of the four locales at an overall average of 43 basis points. That compares to an average of 65 bps in the US, 90 bps in Europe and 114 bps in the specials-heavy markets of the Far East and Australia Pacific (see Figure 1). Canada's low fees to borrow relative to other regions is another reflection of its economic stability.

Like the US, Canada is primarily a general collateral market. On a typical day, upwards of four-fifths of Canadian securities lending transactions will be traded at general collateral levels (see Figure 2). The US mirrors that paradigm, while Europe and the Far East and Australia Pacific have considerably more warm and hot trades. In Europe, about two-thirds of trades are typically general collateral, while in the Far East and Australia Pacific, the number is much smaller at approximately one-third, according to a DataLend analysis of trades last year.

There are exceptions, of course. Last year a handful of equities heated up in the financial news headlines and in securities lending activity too, leading to an increase in the share of stocks trading in the 500-plus bps fee bucket in the spring and summer of 2013, as illustrated in Figure 1.

Perhaps most notably, BlackBerry's travails and steady stock price decline led to a spike in short interest last year, lifting fees to borrow for hedge funds looking to short the beleaguered stock. Lately, as the stock price has rebounded some since the latter part of 2013, fees to borrow have dropped substantially to a lukewarm 30 bps today. From a short perspective, it seems the street now believes the bottom is in. Indeed, some analysts have recently posited that BlackBerry may actually turn a profit by the end of 2015.

Telus, another Canadian company in the IT sector, also heated up last year. As opposed to short selling as was the case with BlackBerry, the securities lending activity in this stock accelerated amid a corporate action situation whereby the company exchanged non-voting shares for common shares in early 2013. What followed was diminished supply as lenders pulled back inventory prior to the corporate action and also recalled stock subsequent to it, both resulting in soaring utilisation and fees to borrow. The stock now trades at general collateral levels.

Loblaw was another actively traded name in the Canadian securities lending market, one driven by M&A arbitrage activity as the food retailer moved to acquire Shoppers Drug Mart in July of 2013. Fees to borrow that stock gradually dropped to lukewarm territory as the acquisition neared its close date in March of this year.

All in all, the Canadian market appears to be steady-as-she-goes once more with the proportion of hot trades thinning out again while general collateral trades still dominate. In that regard, apart from sheer volumes, the world's second largest securities lending market looks quite like the first.

Chris Benedict will give the annual Canadian Market Update at the Canadian Securities Lending Association (CASLA) Conference on Securities Lending on May 8 in Toronto.

Figure 1: fee bands as a percentage of total on loan—Canadian equities (in bps)

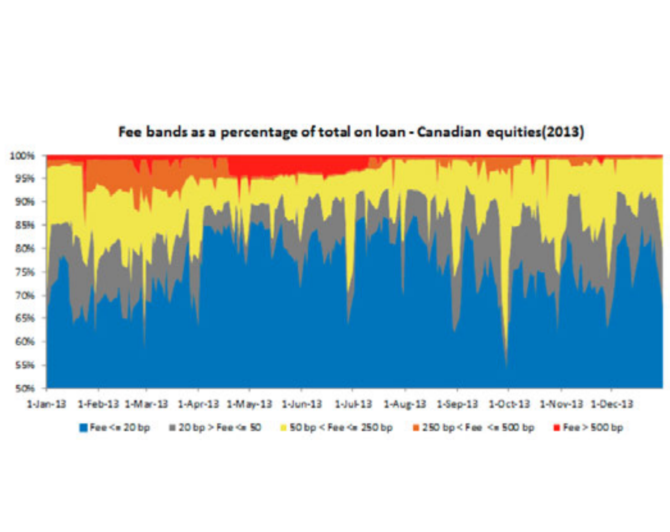
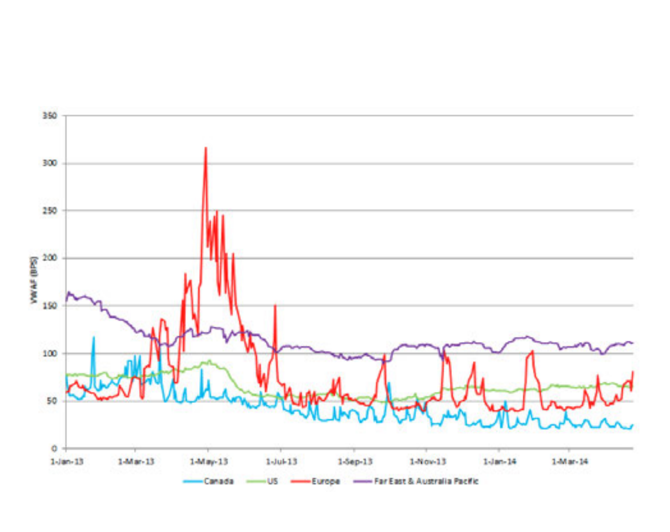


Figure 2: global equities, volume-weighted average fees (bps)



The evolution of securities lending

David Lewis of SunGard's Astec Analytics takes a stroll down memory lane in celebration of the Securities Lending Times centenary issue

In recognition of Securities Lending Times hitting its centenary issue, this article looks back to June 2010 to see how our industry has changed over that time. Securities lending is an evolutionary business rather than a revolutionary one. While we may sometimes wish it to be otherwise, it remains a steady revenue generating and low-risk service element of the wider financial markets.

Looking through Issue 1, it seems that some things never change; the inaugural issue features comments on the possibility of a financial tax on banks as well as a panel of industry figures discussing topics such as regulatory change, flattening revenues, the return of stability and even an article suggesting Asia is the source of future growth for the industry. Sound familiar?

That is not to say that change has not been apparent in the industry: new regulations, new trading structures, a handful of lawsuits and the spectre of a financial transaction tax looming in the shadows. Opinions differ widely as to what this all means for the market and how it might affect the various stakeholders—the beneficial owners, their agents, the borrowers and the hedge funds.

Looking across the industry from the privileged viewpoint of an observer gives the impression that while the industry itself may not be getting smaller, it may well contain fewer players in the future compared with almost four years ago when Securities Lending Times first went to print.

No matter what position they hold in the transaction chain, every market participant shares one common goal—to make a return. With the ever-increasing cost of running each part of the business arising from oversight requirements, reporting, capital constraints, regulatory burdens, etc, growth can only come from operational efficiency. This can manifest itself in a number of ways, but when the demand element cannot be grown (you can't make a hedge want to borrow a security or an issuer pay a dividend), your only options are to get a bigger slice or retain more of the slice you have.

With supply in the market not being a problem, and the cost of maintaining clients rising, a rationalisation of clients could well be expected and an increased focus on high yielding trades emerging. Concentrating on high-value clients with assets borrowers want to pay premium rates to borrow means that the service provid-

er's costs are likely to fall as returns on capital employed rise, and those clients that do remain retaining a bigger slice of the available revenue pie. Everyone is a winner—excluding those who are no longer in the business of course. However, some might argue that those clients that do depart were those where securities lending ceased to be a valuable part of their activities.

Do the revenue numbers support this changing pattern though? Are rates and returns rising as lenders focus on high-value opportunities and borrowers crowd the relatively few high-yielding trades?

Figure 1 shows the changing weighted average fees by fee range group over each of the last four full years—ie, since the year Securities Lending Times started. As Figure 1 indicates, the intensity of trading activity for loans above 500 basis points in fees has increased, pushing the weighted average higher following a slight dip in 2011. The weighted average fee levels for the lower fee bands have, by contrast, fallen over the period, again with an upward blip in 2011.

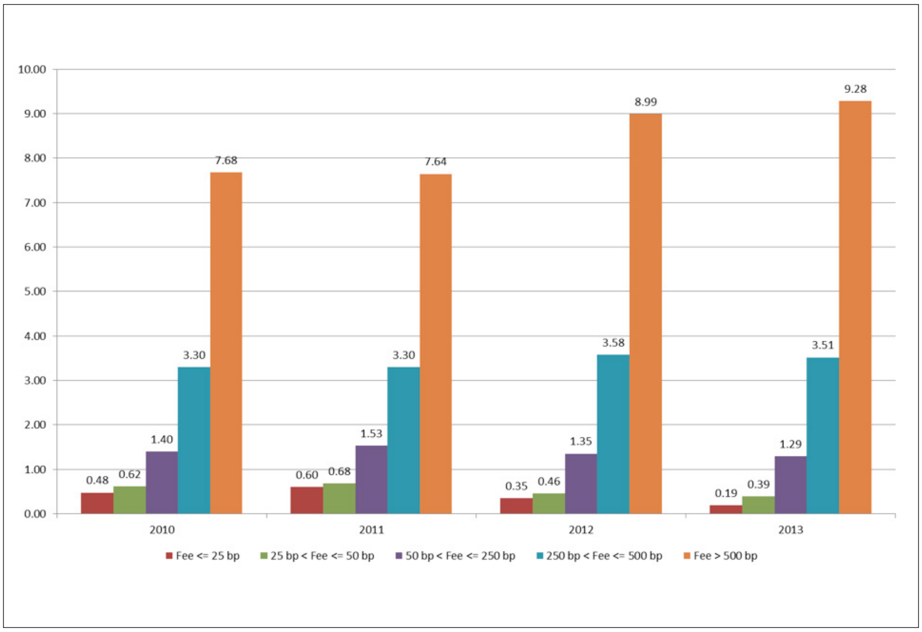


Figure 1: weighted average fee rates by fee group 2010 to 2013. Source: SunGard's Astec Analytics

Figure 2 shows how these changes relate to actual revenue generation—increased weighted average fees are not enough on their own. Volumes have to remain steady or rise to create revenue growth, at least as a proportion of the revenue pie overall. Note how the importance of higher rated trades (over 500 bps weighted average) increases over the last four years with the share of 2013 accounting for 46 percent of gross revenue; while less than 2012 it is significantly more than our earliest Astec data from 2005, which had the highest fee group representing only 7.6 percent of the total revenue and the lowest 43 percent—almost a reversal of the revenue distribution in the space of eight years.

In terms of volume on loan, in 2010 the top fee range group (more than 500 bps) accounted for less than half of one percent while general collateral trading at 25 bps or less was responsible for more than 93 percent of volume.

The contrast with 2013 is marked—the proportion of the market on loan at rates of more than 500bps doubled to 0.9 percent, but this translated into a six-fold increase in the share of revenue generated. The most significant change in volume occurred in the 25 to 50 bps range stealing the most from the sub 25 bps bracket. This sector rose five-fold from less than 2.5 percent to more than 12.5 percent of traded volume, but almost halved in its importance revenue-wise relative to the total.

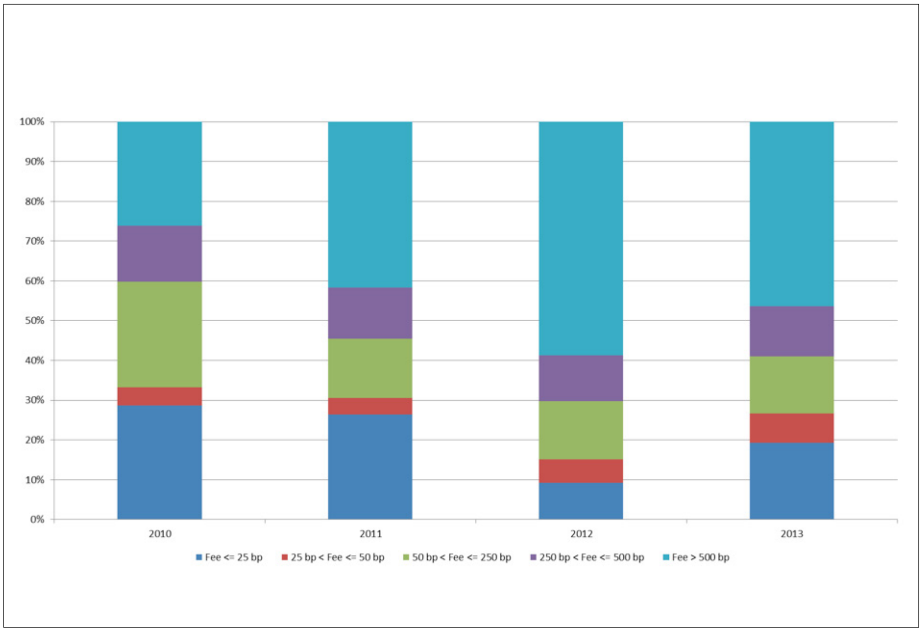


Figure 2: proportion of total revenue created by fee group 2010 to 2013. Source: SunGard's Astec Analytics

Looking at the market data would certainly suggest that our market has changed in shape and substance even over the last four years. Revenue generated is being concentrated in higher value trades, which tallies with the participants' focus on increasing their returns on capital employed. This may well translate into a smaller market as some supply leaves, but it may also represent a leaner, fitter business going forward.

While the supply appears to remain well in excess of the demand levels, even when the expectations for the collateral transformation trade are factored in, then this increasing focus is likely to continue. If the tsunami of demand for high-quality liquid assets does indeed come, this may well attract more supply back into the game, but at present it would seem that an increasingly healthy business is continuing to emerge from the turbulence that has characterised the last few years. **SLT**

David Lewis
Senior vice president
SunGard's Astec Analytics

Industry appointments

Deutsche Bank has created an investor services business within its trust and securities services/cash management financial institutions, appointing **Rafael Moral** as global head of the business.

The business is made up of custody and clearing, agency securities lending, and fund services.

These three businesses previously formed direct securities services (DSS), but their repositioning as investor services is a reflection of their importance, the opportunities for realising synergies, and clients' increasing demand for solutions spanning these products, according to an internal memo.

Moral will become global head of investor services, reporting to Satvinder Singh, effective June 2014.

For the past three years, Moral led global transaction bank's (GTB) strategy and business development function after joining as COO of Germany in 2010.

Prior to that, he spent eight years with group strategy at Deutsche Bank, most recently as head of the Asia Pacific and China, following roles in the Americas and in Europe.

Thibaud de Maintenant, current head of DSS, has been appointed GTB head of France. His appointment reflects the importance the bank places on Europe's third largest economy and its ambitions for this market, said the memo.

He will begin his new role in July 2014 and will report to Stefan Bender, GTB head of Europe, the Middle East and Africa.

Dan Hoover, **Jerry Mauricio** and **Susan Gibbs** have joined BMO Global Asset Management.

The trio will work in the firm's US office, which is located in Chicago.

Hoover has been appointed as director of securities lending and relationship development and will report to BMO Global Asset Management managing director Kirsty Perez.

Hoover has nearly 30 years of experience in securities lending, and previously served as senior vice president of a Chicago-based bank.

Mauricio will serve as the chief compliance officer at BMO Global Asset Management.

He has more than 25 years of investment experience.

He previously worked as senior vice president and wealth management chief risk officer for Bank of the West, a BNP Paribas subsidiary.

Gibbs has joined BMO Global Asset Management as a DCIO (defined contribution investment only) internal sales consultant. She will work with the managing director of intermediary and retirement distribution, Ben Jones.

She has extensive experience as a financial advisor and previously worked as a relationship manager of an independent broker-dealer.

Barry McInerney, co-CEO of BMO Global Asset Management, commented on the appointments: "With Hoover, Mauricio and Gibbs joining the firm, we are adding experienced talent to our exceptional team."

Claire Davis has joined the International Securities Lending Association (ISLA) team in London.

She is the fourth permanent member of staff at ISLA and is joining from State Street Europe, where she was part of the securities lending relationship management group.

With a knowledge the agent lending side of the market, she will be working with chief executive Kevin McNulty and COO Andrew Dyson to further develop and service the association's pan-European membership.

The asset management firm AMP Capital has appointed **Kate Campbell** as institutional director of Europe, to be based at the firm's London office.

Campbell will work alongside Louisa Yeoman, the institutional director of UK, to develop AMP Capital's European institutional client business. She will report to AMP Capital managing director of Europe, Middle East and Africa, Richard Shields.

Shields said: "I'm pleased to announce Campbell's appointment at an exciting time for AMP Capital given the recent launch of our UCITS platform for global listed infrastructure and global listed real estate."

"[Her] efforts will be focused on fundraising for this new platform and for AMP Capital's unlisted infrastructure business where we already have a range of well-established equity and debt funds. She will work with clients such as pension funds, insurers, private banks and multi managers."

"Campbell has extensive experience working with clients in Europe and a deep knowledge of the local market, which will be critical as we take our growing capabilities to a new group of potential investors."

Campbell joins AMP Capital from J.P. Morgan where she was executive director of capital introduction in the prime brokerage area.

While at J.P. Morgan, Campbell worked with more than 300 global hedge funds assisting them with their marketing strategies. She has held roles at Deutsche Bank, Equity Capital Markets and Goldman Sachs.

John Groetchas has become the regional sales director for the Americas at Lombard Risk.

His recruitment follows that of Simon Parkins, who joined the firm as global sales director.

Gretchas previously held senior sales roles at Markit Analytics in New York, and was head of risk sales at Calypso US, COO of Razor Risk Technologies and co-founder of Treasury Management Systems Inc.

He previously led the FX department at Dresdner Kleinwort Benson and the Frankfurt sales team at Deutsche Bank.

John Wisbey, CEO of Lombard Risk, said: "As a seasoned financial services practitioner, I am confident that Gretchas will drive the Lombard Risk team forward in the Americas."

Max Hayden has been hired as BSC Financial Group's head of business development.

Hayden will be based in London and will report to the London board.

Hayden has 25 years of experience in investment banking and previously served as the managing director for the European prime brokerage business at Bank of America Merrill Lynch.

While at Merrill Lynch, Hayden served as COO for global equity finance, and head of the prime brokerage platform.

The hire follows the appointment of former Liquidnet chief John Barker as executive chairman of BCS.

Marat Ibragimov has also been appointed as a senior equity analyst.

Barker commented on the hire of Hayden: "[His] appointment reaffirms BCS's commitment to international business. He has a track record of success at the very highest levels of our industry and his appointment is proof positive of our ability to attract the best people in the marketplace"

Ibragimov has 17 years of experience in financial markets. In his new role, he will cover consumer discretionary, food retail, pharma and real estate markets.

Prior to joining BCS, he worked as a senior equity researcher analyst at Uraislib Capital and has expertise in Russian equities and knowledge of Russian real estate markets.

In 2013, BCS secured a membership of the London stock Exchange and was granted UK approval by the Financial Conduct Authority, marking the official launch of its international brokerage business.

Filippo Santilli is the new head of Asia-Pacific sales and relationship management for BNY Mellon's global collateral services business.

Santilli will be based in Hong Kong, but will work alongside executive vice president Jonathan Spirgel in New York, and the head of global collateral services, Dominick Falco, in the Asia Pacific.

He has more than 15 years of experience in institutional sales, and previously worked at Lehman Brothers Asset Management. In his former role, he worked as a product specialist in Hong Kong.

Santilli joined BNY Mellon in 2009. He eventually became the managing director of liquidity services for the Asia Pacific.

The appointment of Santilli is to help Asian buy-side clients manage the impact of regulatory changes on their investments.

Santilli stated: "We are seeing an increase in those same global broker-dealers looking to become more efficient with servicing their Asian clients and optimising their assets."

He added: "Resources are constrained and efficiency is a big driver of the demand for collateral services. The challenge is having the infrastructure to 'unlock' these assets, which is where BNY Mellon can help."

Falco commented: "This is a particularly important issue in Asia-Pacific. collateral is now an intrinsic part of a firm's risk management framework."

"Accordingly, we are expanding our team and investing in our collateral services infrastructure to ensure broker-dealers have the ability to collateralise transactions, both domestic and cross-border, securely and transparently."

Law firm DLA Piper has bagged **Bart Chilton**, a former commissioner at the US Commodity Futures Trading Commission.

Chilton has been appointed as the senior policy advisor of DLA Piper's Washington DC office.
He has 30 years of experience in US government, where he worked in the executive branch during Bill Clinton, George Bush and Barack Obama administrations.

During his tenure as a CFTC commissioner, Chilton chaired the CFTC's energy and environmental markets advisory and global markets advisory committees, and assisted industry participants with the requirements of the Dodd-Frank Act.

"The addition of Chilton will enhance the capabilities and visibility of our global swaps practice, as well as our access to other key decision makers with regard to recent rulemaking," commented Marc Horwitz, head of DLA Piper's derivatives practice.

"In addition to providing his unique insight on Dodd-Frank, Chilton will assist our cross-border team in navigating thorny issues surrounding equivalency with comparable regulations that are being enacted in other jurisdictions."

A source has confirmed that **Rob Chiuch** will assume global trading responsibility for the agency securities lending programme within BNY Mellon's global collateral services business.

Chiuch, who joined the company in 2011, is currently managing director and global head of equity finance for BNY Mellon's global collateral services business.

He is to take over as the global head of equities and fixed income for securities finance trading.

Chiuch will still report to James Slater, executive vice president and global head of securities finance at BNY Mellon.

The position was announced internally recently, with a different source commenting that there is a likelihood that the fixed income department will be restructured in due course. **SLT**

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4th Annual CASLA Conference on Securities Lending

Date: 8 May 2014
Location: Toronto
www.canseclend.com

The 4th Annual CASLA Conference on securities lending will take place this year on 8 May 2014 at The Omni King Edward Hotel, Toronto, Canada.

For more information about the 4th Annual CASLA Conference on securities lending, please contact cibcmellon@cibcmellon.com

3rd Annual Collateral Management Forum

Date: 22-23 May 2014
Location: Austria
www.globalleadingconferences.com

GLC Europe has organised the 3rd Annual Collateral Management Forum to bring together the most sought after people in this industry under one roof on 22 and 23 May 2014, Vienna, Austria. As usual, the event will provide solutions for the most emerging topics and bring together senior C-level executives from the biggest and top European banks, institutions and regulatory bodies.

ISLA's 23rd Annual Securities Finance and Collateral Management Conference

Date: 17-19 June 2014
Location: Berlin
www.isla.co.uk/isla2014

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Date: 24-25 June 2014
Location: London
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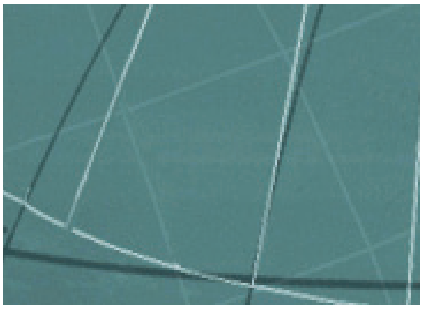
Enterprise Collateral 2014 is the only conference to bring together the treasury, front, middle and back office from financial institutions to source enterprise wide solutions for optimising collateral.

Global market reach. Expertise in Canada.



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