SLT SecuritiesLendingTimes
ISSUE157
02.08.2016 TUESDAY
securitieslendingtimes.com
The primary source of global securities finance news and analysis

Brian Lamb, CEO of EquiLend, welcomed the acquisition, saying it highlights “the potential benefits of using central clearing services” to the industry

EquiLend acquires AQS

EquiLend has acquired Automated Equity Finance Markets, commonly known as AQS, for an undisclosed amount, paving the way for “unprecedented access to central clearing services”.

The deal, which was completed on 31 July, sees EquiLend take charge of AQS and related technology from PDQ Enterprises, the service’s owner since it bought Quadriserv in August 2015.

AQS will be rebranded as EquiLend Clearing Services. Existing clients will be able to continue to use the service undisrupted to connect to the Options Clearing Corporation’s (OCC) Market Loan Program. EquiLend intends to connect its trading and post-trade services, including Next Generation Trading, with AQS by the end of 2016.

AQS CEO Pat Cestaro and co-founder Greg DePetris will remain as senior advisers to EquiLend regarding central counterparty (CCP)-related issues.

Cestaro commented: “As the securities finance industry has evolved—from new technologies to new regulations and more—it was critical for AQS and the key stakeholders in the industry to arrive at the best model for long-term marketplace operation.”

“We believe this transaction reflects a clear measure of success in defining that relationship and are happy to be working with EquiLend to see so many years of hard work at AQS turn into a positive outcome for the industry.”

Continued on page 2

J.P. Morgan plans to close GSF repo settlement by end of 2017

J.P. Morgan is winding down its government securities settlement services with a view to exiting the business by the end of 2017.

The decision will primarily affect the bank’s general collateral finance repo settlement and settlement of auctions guaranteed by Fixed Income Clearing Corp.

The closure of its government securities settlement services will affect a small number of clients in the US, which are mainly broker-dealers.

In a statement on the decision, J.P. Morgan said that the repo settlement service is a “non-core” service that was being closed in favour of focusing on other strategic growth opportunities through a more streamlined business model.

Continued on page 2

CBRT commits to ‘limitless’ QE

The Central Bank of Turkey has pledged to provide the country’s banks with limitless liquidity to ensure financial stability in the wake of recent economic and political turmoil.

The central bank set out several financial measures to minimise market disruption, which has been linked to the failed military coup that took place on 15 July.

In a statement on its revised monetary policy, the central bank acknowledged Turkey’s political troubles, stating that, “recently, domestic developments have led to fluctuations in financial markets”.

To combat these fluctuations, the Central Bank of Turkey confirmed that the commission rate for intra-day liquidity going forward will be zero.

Continued on page 4

EquiLend acquires AQS

Continued from page 1

Brian Lamb, CEO of EquiLend, said of the acquisition: "Momentum has been building in the past two years in support of CCPs in the securities finance marketplace. Balance sheet costs, risk weighting and tougher capital-adequacy requirements have highlighted to the industry the potential benefits of using central clearing services."

"This acquisition combines EquiLend's broad client base, market expertise and trusted technology with Automated Equity Finance Markets's proven CCP-based securities lending market technology. By providing seamless access to OCC's Market Loan Program, the securities finance market now will have unprecedented access to central clearing services."

Craig Donohue, executive chairman of OCC, added: "We look forward to working with EquiLend to design and deliver solutions that allow for broader access to cleared solutions and the capital and risk management benefits that are realised with OCC's clearing programmes."

"By working with AQS, and now EquiLend, OCC is continuing to expand its strong foundation in clearing and risk management capabilities for securities lending, as reflected by the 5,000-plus loans processed daily and approximately $130 billion in risk-managed open loans."

The acquisition of AQS follows hot on the heels of the launch of Swaptamization, EquiLend's new service for total return swaps, and the roll-out of the Next Generation Trading (NGT) securities finance trading platform.

Asked if there might be more acquisitions or new product launches in the near future, Lamb said: "Through discussions with our board, our global client base, industry associations and regulators, EquiLend is continually evaluating where there are inefficiencies in the securities finance marketplace and considering how we may be able to mitigate them."

"Sometimes that results in the expansion of an existing service (such as Trade Match, Unified Comparison) or the launch of a new service (NGT, Swaptimization) or, in this case, acquiring technology that we believe would offer greater value to the global securities finance market if it were incorporated into our suite of services."

J.P. Morgan plans to close GSF repo settlement by end of 2017

Continued from page 1

J.P. Morgan added: "We expect the majority of client transitions to be completed by the end of 2017. We have built our custody, collateral management, prime brokerage and treasury services businesses into leading franchises, and in no way are those growing businesses affected by this decision."

A recent review of US triparty repo collateral liquidity revealed that US government securities still account for nearly half of the total asset pool.

The review, conducted by the Securities Industry and Financial Markets Association (SIFMA), showed that US government securities make up 48.5 percent of the triparty repo market, which itself makes up a significant portion of the entire US repo market.

Agency mortgage-backed securities and collateralised mortgage obligations account for 30.1 percent, and equities make up 7.1 percent of the triparty repo market. The remaining collateral pool is made up of non-agency mortgage-backed and asset-backed securities, corporate bonds, federal agency and government sponsored enterprises securities.

In its annual US repo factsheet, which was updated on 21 July, SIFMA valued the daily turnover of the entire US repo market at $2.2 trillion.

Contents

CBRT commits to 'limitless' QE

Continued from page 1

Banks will also be allowed to place foreign exchange deposits as collateral without limits for required Turkish lira liquidity.

All markets and systems, including the electronic fund transfer and the electronic security transfer and settlement systems, will be left open until final settlement of transactions.

Shortly after these measures were announced, the central bank also adjusted its short-term interest rates to better suit the country's market environment.

Overnight, interest rates were reduced from 9 percent to 8.75 percent, while the borrowing rate and one-week repo rate were kept at 7.25 percent and 7.5 percent, respectively.

The borrowing rate for the late liquidity window, which is held between 4pm and 5pm, has been kept at 0 percent, while the lending rate has been reduced from 10.5 percent to 10.25 percent.

Piotr Matys, a research analyst at Rabobank, suggested that the political fallout caused by the attempted overthrow of Turkish President Recep Erdoğan may make foreign investors more cautious and lead them to reduce their exposure to Turkish assets.

"A wave of capital outflows cannot be excluded, which would exert a selling pressure on the lira. A more volatile and depreciating currency accompanied by concerns about more terrorist attacks may lead to a weaker economic activity as households shift to a saving mode and corporates postpone strategic investment decisions," said Matys.

"The Central Bank of Turkey may have to pause its process of simplifying the monetary policy by narrowing the interest rate corridor at the time when prominent officials expect policy makers to cut rates far more decisively to support investments and consumption."

"Escalating political pressure on the Central Bank of Turkey will undermine already damaged confidence amongst foreign investors following recent dramatic events."

Short sellers target Nintendo

After a sluggish start, short sellers are making up for lost time by quickly building their positions in Nintendo's stock, with short interest rocketing up more than 400 percent in a week, according to S3 Blacklight.

Following the recent release of the global gaming phenomenon Pokémon Go, S3 Blacklight, a US data analyst, recorded a 27 percent drop in Nintendo's share price as of 25 July, down from its year-to-date high of JPY 31,770 (US $301.2) on 19 July. Nintendo owns a 32 percent stake in The Pokémon Company, which manages the franchise, and initially began to draw short interest after it clarified its exposure to Pokémon Go's success and confirmed it would not be revising its future earnings forecast upwards, despite the game's global popularity.

The Japanese videogame company described Pokémon Go-related revenues as "limited" and stated that it had already been incorporated and gains from the game's success into its revenue forecasts, in a statement on 22 July.

Nintendo's Q1 results revealed an overall loss of JPY 5.1 billion (US $49 million), primarily as a result of the strong yen.

ESRB assesses risks in sizeable EU 'shadow banking' market

The total outstanding value of EU securities on loan reached €501 billion at the end of

2015, the European Systemic Risk Board (ESRB) has reported.

This figure, comprised of government bonds (€304 billion), corporate bonds (€39 billion) and equities (€158 billion), was reported in the first EU Shadow Banking Monitor, an annual series looking at the growth in ‘shadow banking’ activities since the financial crisis of 2008.

Using IHS Markit Securities Finance data, the ESRB found that securities lending, long described as a shadow banking activity by regulators, largely utilised non-cash collateral in 2015, with equities volumes peaking during Q2 thanks to dividend arbitrage trading.

In terms of risks, the ESRB pinpointed agent lenders as a worry, due to their significant stake in the business, which was put at around €500 billion, including €304 billion in government bonds lending, “although no comprehensive regulatory or official sector data are currently available”.

The ESRB is also worried about the risks associated with cash collateral reinvestment and non-cash collateral reuse, because they “imply that overall credit provision to the financial system might be much greater than the headline estimates available through commercial databases”.

Despite a lack of data, the ESRB surmised that the “degree of interconnectedness is likely to be very high, given that investment fund and ICPF assets are often held in custody in financial institutions (custodian banks) that lend securities on behalf of their clients”.

“Agent lender data indicates that three quarters of the securities available for lending were managed by the reporting entities on behalf of non-EU clients, suggesting significant cross-border linkages between EU and non-EU jurisdictions,” the ESRB added.

There is also a “potentially significant run risk”, due to transactions being performed on an open maturity basis, which may “be exacerbated by the fact that most of the cash received against EU client assets is managed in comingled accounts rather than separate accounts”.

“Assets managed in comingled accounts create greater incentives for ‘runs’ by clients. Based on the limited data available, liquidity risks seem somewhat contained, as cash collateral reinvestment goes mostly into high-quality assets.”

New mandate for Euroclear-DTCC

Northern Trust has adopted the margin settlement service offering of GlobalCollateral, the joint venture between Euroclear and the Depository Trust & Clearing Corporation (DTCC).

The GlobalCollateral Settlement Messaging Service automates collateral settlement tracking in a bid to improve custodian communications and client service.

By removing the manual processes involved in the margin call procedure, it is intended to improve collateral movement with settlement instructions. The service delivers instructions to the appropriate custodian and sends confirmed details back to Northern Trust and its counterparties. It also provides automated notification of completion and receipt.

According to GlobalCollateral, the service was launched as a response to global derivatives regulations that are likely to create an increase in margin calls, and operational complexity.

It is intended to improve operational efficiency, reliability and transparency, while also generally streamlining the process. Northern Trust will go live with the service in the first half of 2017.

Mark Jennis, executive chairman at GlobalCollateral, said: “Global derivatives regulation and the resulting increase in collateral

calls will require market participants to improve their collateral management processes."

He added: "It is great to see Northern Trust and other leading global fund administrators recognise the benefits of an automated margin call process, including lower operational risk, increased transparency and improved client and counterparty satisfaction."

Tesla's ambition drives shorting

Household names in technology and manufacturing dominated the FIS Astec Analytics Hot Stocks list for the week beginning 18 July.

For the Americas, it was the ever-present automotive and energy company Tesla Motors that once again claimed the top spot for the region.

Tesla's share price closed the week at $222.27, up $1.87, with short interest down by 10 percent. However, Astec Analytics noted that, as a proportion of the shares available, this number fell half as fast, suggesting that institutional ownership continues to contract.

Japanese videogame company Nintendo easily came first in the Asia Pacific after the reality of its limited connection to the recent craze of Pokémon Go, and its revenue potential, became clear a note to investors.

Initially, the augmented reality game's launch caused Nintendo shares to soar by 121 percent, from just above a 12-month low of JPY 14,380 (US $139.3) on 6 July to JPY 31,770 (US $301.1) only two weeks later.

Short interest subsequently boomed, jumping 246 percent in the past week and Nintendo share price ended the week down 12.5 percent, according to Astec Analytics.

In Europe, Wirecard remained top of the pile, despite seeing its short interest falling significantly in recent weeks, with a 20 percent drop in the past week alone.

The volume of shares borrowed as a proportion of those available is down from 60 percent to 40 percent.

Securities lending deserves own contract

Rising costs and a greater diversity of providers is leading pension funds to request unbundled contracts for securities lending and custody, according to Funston Advisory Services.

Funston's independent audit of the New York State Common Retirement Fund, which is the

third largest state US pension fund with $178 billion in assets, revealed that it is holding preliminary discussions to develop a new request for proposals for custodian bank services, including securities lending.

J.P. Morgan provided custody, securities lending and foreign exchange services to the fund under a five-year deal until June last year, with one-year extensions expected to continue the partnership until 2017.

“Following the credit market collapse of 2008-09, the New York State Common Retirement Fund and the majority of public pension funds adopted more conservative policies for securities lending,” according to Funston.

“Discussions with the New York State Common Retirement Fund suggest that the objectives and scope of its lending programme are likely to remain essentially the same in the next bid process. However, changes in markets, regulatory environment and technology have increased the range of options for lending securities.”

Unbundling would make it easier to end a securities lending or foreign exchange mandate without affecting the custody relationship, while maximising the opportunity to secure the best provider.

“While this approach may result in higher apparent costs for custody, it should improve transparency of actual costs, enhance securities lending and/or foreign exchange performance, and provide the opportunity to consider use of agency firms whose sole responsibility is to the client.”

Funston, which reviewed the State of New York’s retirement fund’s internal operations between 2013 and 2015, stated: “We believe this [separate mandates] would be the best direction for the fund, even if the same provider were selected for all three services.”

Northern Trust settles litigation and enjoys higher spreads

Northern Trust will have to pay $46.5 million to settle securities lending litigation, while the bank outperformed the previous quarter in fees earned, according to its Q2 results.

The $46.5 million sum will settle unspecified securities lending litigation, but it is still subject to court approval, according to Northern Trust. The figure falls to $28.9 million after tax.

Northern Trust’s corporate and institutional services business earned securities lending fees of $26.8 million during Q2 2016.

Q2’s fees were up 18 percent from Q1’s $22.6 million and remained the same year over year.

Commenting on Northern Trust’s overall performance, Frederick Waddell, chairman and CEO, said the bank continues to effectively navigate a volatile market amid heightened global economic uncertainty.

“Total revenue increased with strong growth in net interest income and steady growth in trust, investment and other servicing fees, partially offset by lower foreign exchange trading income. We continued to invest in people, technology and regulatory initiatives to support our growing business. Our results for the quarter demonstrated our ability to win new business in the current environment.”

Deutsche Bank chooses SWIFT

Deutsche Bank global transaction banking has selected the SWIFT Scope solution for intraday liquidity reporting.

The solution will support compliance with the Basel Committee of Banking Supervision (BCBS) 248 requirements for banks to submit detailed reports on intraday liquidity flow in every country and currency they operate in. All banks will have to comply with BCBS 248 by January 2017.

According to SWIFT, the SWIFT Scope solution can also encourage use of intraday liquidity reporting for active liquidity management.

It is designed to provide flexible and automated business intelligence that can be tailored to collect and consolidate particular data sets.

The solution then analyses and monitors the data, allowing for accurate reporting of intraday liquidity flows.

Andreas Hauser, business product manager for intraday liquidity management at Deutsche Bank's institutional cash management and global transaction banking segment, said: "The BCBS requirements aim to enable banking supervisors to monitor a bank's management and intraday liquidity risk and our clients are looking for data to support active liquidity management."

"SWIFT Scope provides an excellent intraday liquidity management solution to meet these requirements," Hauser added.

Michael Formann, head of SWIFT for Germany and central Europe, commented: "SWIFT Scope is a tailored, modular solution that can comply with the BCBS 248 reporting requirements and enable banks to do analytics on the data collected and leverage the insights gained for liquidity management purposes and other requirements."

Osaka Exchange adopts Nasdaq matching engine

The Osaka Exchange (OSE) has gone live with Nasdaq's next-generation derivatives trading system.

The new matching engine is intended to improve the exchange's performance and to allow for more flexibility and longer trading hours, all of which will contribute to further business expansion.

Osaka, a wholly-owned subsidiary of the Japan Exchange Group (JPX), has also launched Nasdaq's SMARTS technology for real-time, cross-market surveillance and its pre-trade risk management technology, TradeGuard, to help improve market safety and integrity.

JPX and Nasdaq have been working together since 2011.

Lars Ottersgård, executive vice president for market technology at Nasdaq, said: "As JPX continues to expand its business both regionally and globally, the technology they've implemented will provide the flexibility and performance capabilities, as well as the risk and surveillance solutions, to help the exchange group meet and exceed their growth plans."

Hiromi Yamaji, president and CEO of OSE, said: "Powered by Nasdaq's trading technology and innovative solutions such as SMARTS and TradeGuard, we will bring our customers the most deterministic trading platform with enhanced surveillance and risk management functions."

"We continue to make every effort to enhance reliability, usability and competitiveness of the OSE market."

Nasdaq's exchange technology is now in operation across 100 marketplaces around the world.

BlackRock enjoys securities lending growth in Q2 2016

BlackRock increased its securities lending revenue to $157 million for Q2 2016, up from $151 million in the same quarter last year.

In its second quarterly report for 2016, the bank grouped its securities lending revenue alongside investment advisory and administrative fees, which brought in a combined revenue of $2.45 billion for

WELLS FARGO SECURITIES

The power of partnership

Prime Finance

Choose a partner who can help you succeed today and grow for tomorrow

At Wells Fargo Securities, we recognize that a partnership is an investment from both parties. That's why we are committed to developing a long-lasting relationship to support your current financing and operational needs, as well as your growth strategies for the future.

Our Institutional Investor Services group supports a broad range of alternative asset managers, from emerging to large institutional funds, and provides the financial, operational, and technical resources needed for success in a rapidly evolving marketplace.

- Prime brokerage, margin finance, and securities lending
- Custody and clearing services
- Fund administration
- Middle- and back-office services
- Capital introductions
- Futures execution
- Exchange-traded and OTC derivatives
- Business consulting

Discover what a partnership can really be.

Contact us to learn more at **wellsfargo.com/prime**.

Q2, down from the Q1's $2.53 billion total. According to BlackRock, this reflected the shift from equities to fixed income and cash products, partially offset by lower yield-related waivers on certain money market funds and the effect of AUM acquired in the BofA Global Capital Management transaction.

"Our clients are facing unprecedented challenges as they attempt to navigate the current investment environment," said BlackRock chair and CEO Laurence Fink, on the firm's overall Q2 financial results.

"Political and macroeconomic uncertainty, historically low yields and elevated market volatility are leading clients to pause, as evidenced by more than $55 trillion in bank deposits in the US, China and Japan alone."

KCG expands in Europe with Neonet

KCG Holdings, the US securities trading firm, is expanding its presence in Europe with the acquisition of Neonet Securities, an independent execution service provider based in Stockholm.

The two firms have entered into a definitive agreement that will see Neonet purchased from its current shareholders, Hay Tor Capital, KAS BANK and Cidron Delfi Intressenter Holding. The financial terms of the deal were not disclosed.

Neonet offers a suite of algorithmic trading strategies, smart order routing and sales trading, as well as post-trade clearing and settlement services. Working primarily with European equities, Neonet is intended to improve KCG's reach in continental Europe.

The acquisition will also give Neonet clients access to a wider range of execution services on an international scale.

Neonet will continue to be led by CEO Tim Wildenberg, from its Stockholm headquarters.

Wildenberg said: "For the last 20 years, Neonet has focused on putting clients first and providing them with transparent execution services, as well as deep knowledge of international financial markets. We look forward to leveraging KCG's significant expertise across asset classes in the U.S. and Europe for the benefit of our clients worldwide for years to come."

Philip Allison, CEO of KCG Europe, commented: "We are pleased to announce an agreement to acquire Neonet, a Nordic pioneer in trading and execution services, as we broaden our European reach and continue to bolster our ability to provide clients with global execution solutions."

IHS and Markit complete merger worth $13 billion, become IHS Markit

IHS and Markit's shareholders have approved a stock merger of the two companies, worth $13 billion.

The newly formed company, branded as IHS Markit, began trading on the Nasdaq Global Select Market on 13 July.

IHS stockholders will receive 3.5566 common shares of Markit in exchange for each share of IHS common stock, which will no longer be traded publicly.

IHS Markit has an 11-person board of directors made up of senior management from both companies.

This includes Lance Uggla, previously Markit's CEO, who has taken on the role of president.

Jerre Stead, previously CEO of IHS, is now chair and CEO of the combined company.

Do you have a story we should cover? Let us know via:
drewnicol@securitieslendingtimes.com

Killing UCITS softly

The clock is ticking for the securities lending industry to convince ESMA of the dangers of mandatory asset segregation under AIFMD and UCITS, which they argue could devastate market liquidity and turn the industry on its head

A crack team of financial industry representatives were invited to Paris by the European Securities Market Authority (ESMA) on 21 July to lay out the case for why asset segregation as proposed under the Alternative Investment Fund Managers Directive (AIFMD) and UCITS V would undermine collateral management, without bringing any of the investor protection it promised.

The European Central Bank, EU Commision, Association of Global Custodians and Association for Financial Markets in Europe, along with industry stakeholders, were all present to discuss the matter ahead of the 23 September deadline for ESMA's call to evidence following its latest AIFMD/UCITS V consultation paper relating to this issue.

The large delegation in Paris heard from multiple industry representatives that AIFMD should adopt an optional asset segregation clause, similar to existing segregation rules such as the European Markets Infrastructure Regulation (EMIR). For example, Article 39 of EMIR requires central counterparties to offer individual client segregation and omnibus client segregation. Mandatory segregation would also make AIFMD inconsistent with the Markets in Financial Instruments Directive, along with a number of other existing regulatory frameworks.

Beyond the regulatory inconsistency, the industry appears united in its belief that demanding mandatory segregation for UCITS and alternative investment funds (AIFs), which both fall under AIFMD's remit, would take a significant chunk of liquidity out the market by burdening the affected fund types with rules that would make them significantly less attractive to do business with, by eliminating their ability to offer intra-day collateral exchanges.

Ross Whitehill, managing director and head of strategic regulatory office and global collateral solutions at BNY Mellon, who was present at the meeting in Paris, comments: "To date, no one has been able to identify for and within the industry any benefit of segregating assets throughout the custody chain."

"The regulators, we believe, understand that and have asked the industry delegation to come up with ways of improving investor protection and speedy return of assets."

A problem shared

The negative consequences for day-to-day trading in a segregated environment versus the current system are laid out in Figures 1 and 2 overleaf. As shown in Figure 1, all assets are equal in that multiple fund types are able to contribute to a single asset pool, which can then be lent out collectively. In this example, XYZ Ltd is able to make a single transaction with the securities lending agent lender in exchange for a single portfolio of collateral, regardless of whether the securities it is borrowing came from one or more of the agent's clients. If that collateral needs to be amended throughout the day, that would also only require a book entry transaction in the agent lender's books and records.

Figure 2 shows a segregated environment where that same request for securities could potentially require several transactions to multiple accounts with collateral and securities being exchanged in a piecemeal fashion if the securities come from UCITS funds or AIFs, which creates new operational and settlement risk exposures for all relevant parties and becomes an administrative headache. Additionally, intra-day collateral substitutions would no longer be possible due the new requirement to physically shift assets from specific segregated accounts around the world.

At the same time, other fund types, such as sovereign wealth funds and pension funds, would still able to pool their resources in omnibus

Figure 1

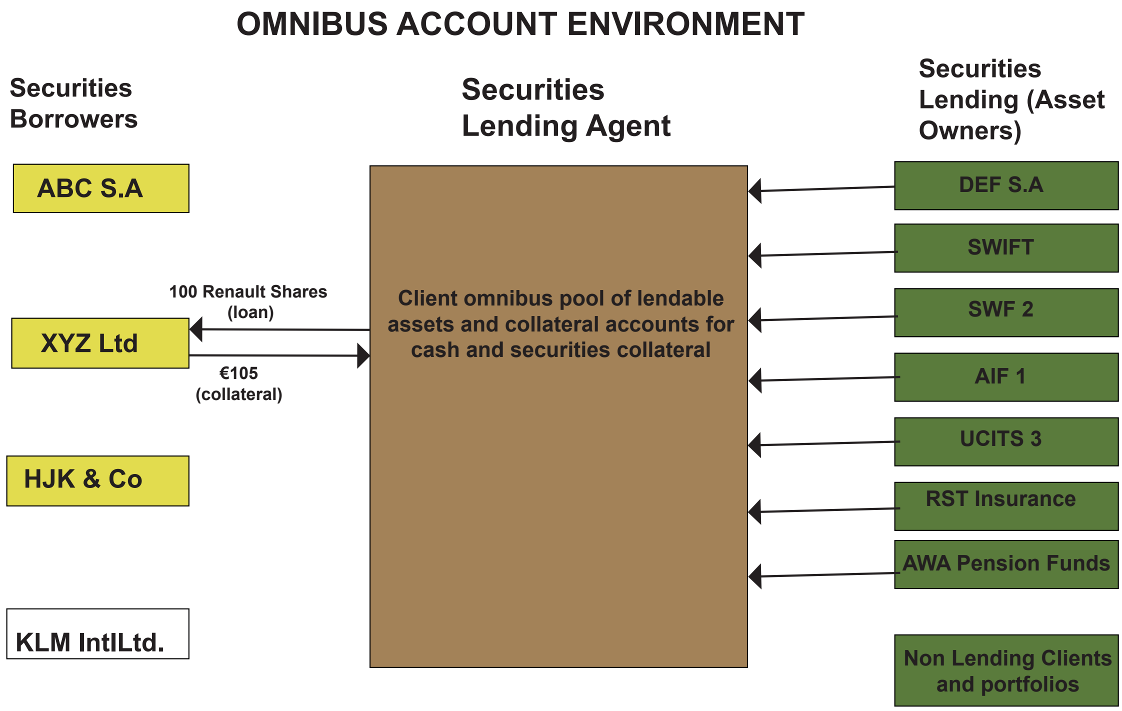
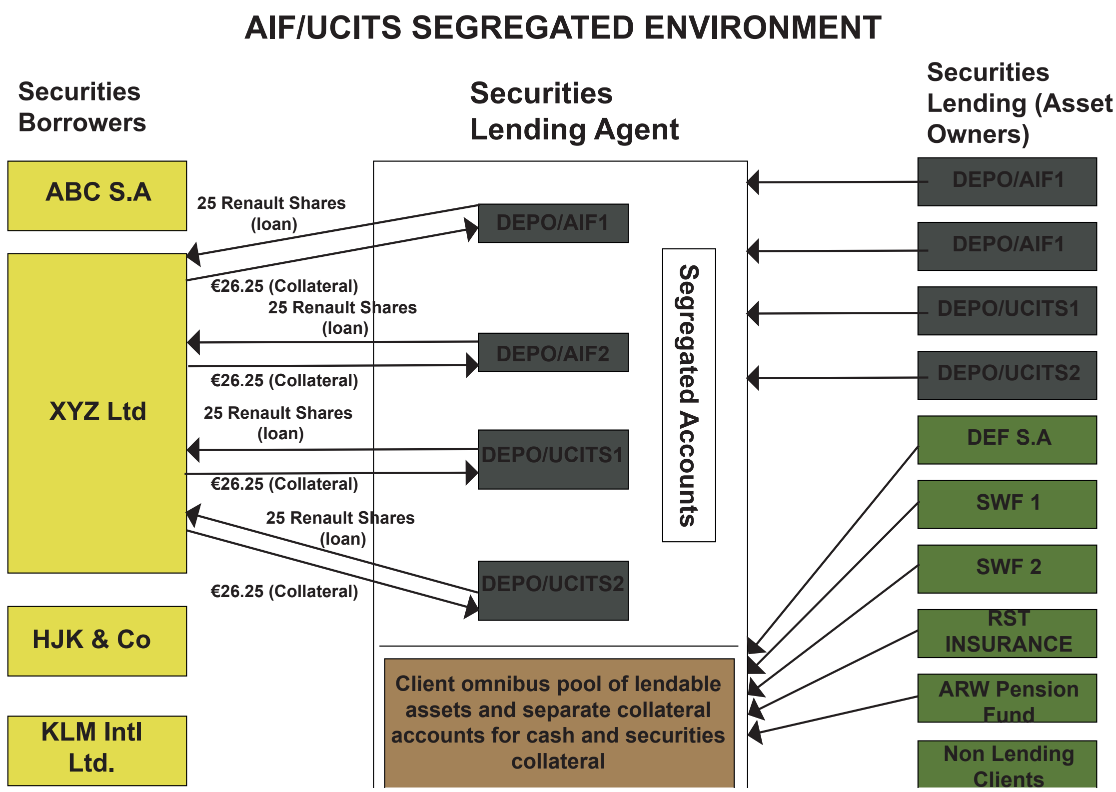


Figure 2



accounts, making it highly likely a borrower will request to use these securities from a single source in order to cut down on the admin required to complete the trade. The result is that UCITS and AIFs are likely to lose out on potential revenue due to the relative complexity of their custody arrangements. On top of all this, they may be asked by their custodian/agent lenders to pay for the privilege of having a segregated account, while receiving no, as yet identified, additional investor protection in return.

According to Whitehill, funds that aren't AIFs or UCITS have an average portfolio penetration in securities financing of around 12 percent. For AIFs and UCITS, it's around 7.7 percent, and while not solely attributable to the fear of segregation, where possible, borrowers are avoiding borrowing AIF/UCITS assets.

"In all probability these fund types [UCITS and AIFs] will have to adjust their benchmarks downwards in the event of mandatory segregation because they would have the additional expense of segregation and a performance drag through lower lending and repo revenues."

Although this should not be considered the death knell for either UCITS or AIFs in securities lending industry, the inevitable performance drag could dissuade potential future investors that value securities lending as a revenue stream from allocating assets to those fund types.

Side effects assemble

Disincentivising the use of UCITS and AIF assets carries significant consequences for the lending market as a whole, but especially for the buy side, which will become increasingly reliant on what's left of the pooled assets. In a single move, ESMA risks upending the current lending market environment from one where supply far outstrips demand to the reverse being true.

For the regulator, an over-reliance on sovereign wealth funds specifically should be a cause for concern because, for the most part, these entities are wholly outside of the remit of the EU and therefore not guided by its high regulatory standards. The funds that EU buy-side participants will be exposed to will likely be Asian and Middle Eastern in origin, both locations that are much more susceptible to 'wobbles' than their western counterparts. Middle Eastern sovereign wealth funds are intrinsically tied to the value of oil, which, given its current trajectory, mean that their high-quality liquid assets may become not so high-quality in the future, and leave EU borrowers with market exposures they are not equipped to manage.

According to the International Securities Lending Association's (ISLA) latest report on the global securities lending industry, 44 percent of the total global lending pool is made up of assets from mutual funds, which are governed by UCITS in the EU. Despite being far and away the biggest contributor to the lendable pool, mutual funds only make up 18 percent of the on-loan balance.

According to IHS Markit, as of 28 July, UCITS funds accounted for just 4.7 percent of on-loan balances. In its report, which was published in March, ISLA stated that it is "likely that this reflects the restrictive regulatory environment applied to this sector in respect of securities lending".

Meanwhile, sovereign wealth funds, which only account for 8 percent of available securities, make up a disproportionately high 13 percent of the total on-loan volume, according to ISLA. Insisting on mandatory segregation would go a long way to compounding this trend further. "Again, sovereign wealth funds (who only comprise of 8 percent of lendable securities) report a disproportionately high 13 percent of all securities on-loan."

"Furthermore, potentially we could see on-loan balances from UCITS continue to decline as asset segregation rules previously applied under AIFMD are more broadly applied to UCITS."

Once bitten, twice shy

Mandatory segregation of assets was originally conceived as a way of forming a new layer of investor protection and transparency that would allow for faster asset recovery in the case of an intermediary insolvency—but the industry has repeatedly highlighted the ineffectiveness of this approach.

The initial argument offered by regulators cited the collapse of Lehman Brothers and the subsequent seven-year saga that PwC, as the administrator of the failed bank's assets, had to go through to return them to investors. However, BNY Mellon commissioned a letter from PwC, which was presented to ESMA at the Paris meeting, outlining why having segregated accounts wouldn't have sped up the process.

Tony Lomas, a partner at PwC and the letter's author, explained: "Even where there were accounts where there were no reconciliation breaks and both the Lehman Brother International Europe (LBIE) statement and sub-custodian statement were aligned, we could not begin to release those assets until we were certain that all of the other accounts were correct, on the basis that, in common with all business failure environments that I have experience of, we could not be sure of the accuracy of LBIE's management information in the immediate aftermath of the collapse."

"More specifically, whilst an insolvency practitioner must respect third-party rights to assets that are in the practitioners possession or under the practitioner's control, the practitioner must satisfy themselves both that the claimant has undisputed legal title to an asset, that no other claimant has a competing claim against the same asset and that the insolvent entity itself doesn't have a right to it."

A second driver behind the regulator's initial desire for segregation was a lingering fear of a repeat of the events around the 2008/09 Bernie Madoff scandal, where Madoff turned his wealth management firm into the world's largest Ponzi scheme. Again, however, Madoff was the fund manager of Bernard L. Madoff Investment Securities and therefore had the authority to access funds throughout the firm, regardless of whether they were in a segregated or omnibus account, and that is still the case today.

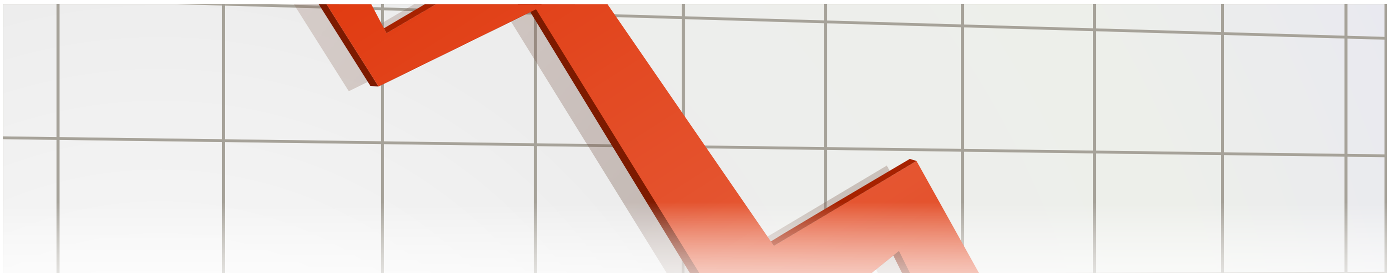
Whitehill offers one explanation for why, given the weight of evidence in favour of optional segregation, ESMA is still entertaining the idea of making it mandatory.

"AIFMD probably started to be drafted before EMIR, and when it was being put together it was shortly after the crash and in response to Madoff," he explains.

"Physical segregation of assets in most respects is old thinking, given that markets are mostly electronic today. When the legislation was being drafted we believe that only the impact on custody was considered. No-one thought about triparty collateral management, financing or securities lending and the impact segregation would have on funding and liquidity."

"The latest meeting was the first time we've had everyone who is relevant to the discussion in the room. Previously we've held such meetings bilaterally. The very positive thing is that all of the national competent authorities and ESMA are listening, are keen to get the rules right, and are willing to do something about it." **SLT**


Because
your best
interests
come first…
Natixis 06/2015 ©Shutterstock.com



Refinery shares stumble as margins crack

Refining shares were the winning energy trade during the recent market slump, but slipping margins have seen these stocks lose their hard-earned gains while also attracting short sellers, says IHS Markit analyst Simon Colvin

Downstream refinery activity proved to be the most resilient part of the oil value chain over the last two years, but the relative stability offered by refining is eroding in the face of growing oversupply.

High distilled goods production and a resulting build-up in unsold inventory have eroded profit margins in the segment. A recent report on oil uncertainty from the US Energy Information Association stated that the pace of gasoline production in June was "likely putting downward pressure" on prices. These refining headwinds are filtering through to company results as oil giant BP, the first integrated oil major to report Q2 earnings, reported its lowest Q2 refining margin since 2010, on 26 July.

These shrinking margins have seen short sellers hone in on refinery exposed shares that make up the VanEck Vectors Oil Refiners Exchange-Traded Fund (ETF), which trades under the CRAK ticker.

These companies have seen their average short interest surge by a quarter since the start of the year and had more than 2.3 percent of their shares shorted at the end of June, the highest level in more than two years. All this runs against that seen in the rest of the energy sector, which has seen shorts cover a fifth of their positions year to date.

US shares most targeted

US refiners have driven this surge in shorting activity as US-traded Western Refining, Hollyfrontier and Pdf Energy make up three of the four firms that have seen their short interest increase by more than 3 percent of shares outstanding since the start of the year. These three firms now make up the entirety of the CRAK constituents that see more than 7 percent of shares shorted.

The other firm seeing a large surge in short interest among CRAK constituents is Japanese refiner Idemitsu Kosan although its ongoing merger with rival Showa Shell Sakiyu could be driving the shorting activity.

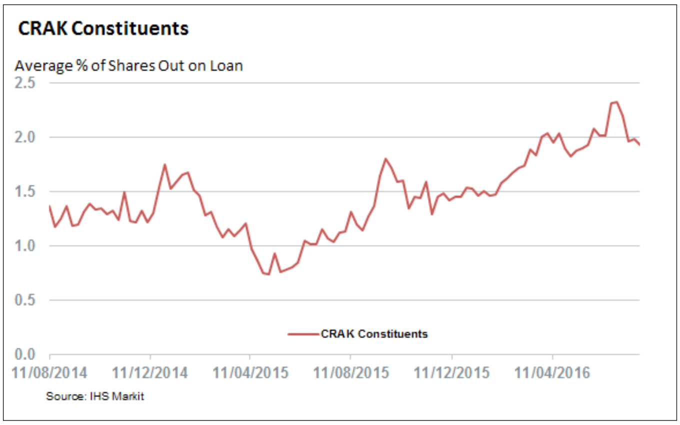
All four firms are due to announce earnings, which should provide greater insight into the situation.

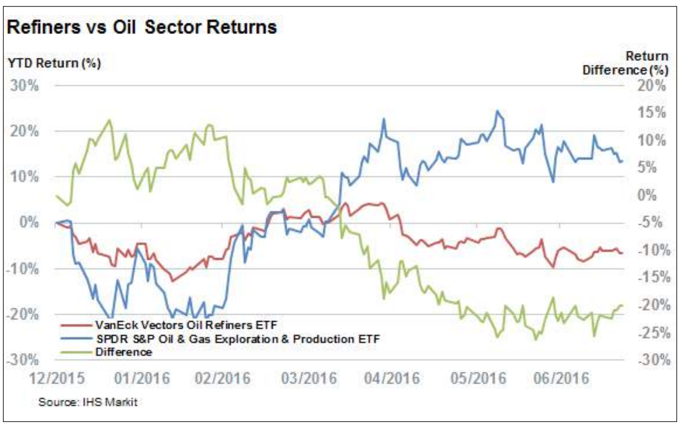
Refinery shares underperform

This surge of shorting activity has occurred in the wake of some fairly severe underperformance for the sector as the CRAK ETF, which was a winning energy bet at the start of the year, has given up all of the relative outperformance. The ETF now lags its largest oil related peer, the SPRD S&P Oil & Gas Exploration & Production ETF, by 20 percent year-to-date on a total return basis.

Most of the increase in shorting activity occurred prior to the most severe underperformance seen since April, which indicates that short sellers have timed their rotation into refiners well. **SLT**

Name	Ticker	Short Interest	Ytd % Change
Western Refining Inc	WNR	7.7	64%
Hollyfrontier Corp	HFC	7.5	620%
Pbf Energy Inc	PBF	7.1	133%
Neste Oyj	NESTE	4.9	7%
Idemitsu Kosan Co Ltd	5019	4.8	193%






IMN
Information Management Network
The 21st Annual European
BENEFICIAL OWNERS' SECURITIES LENDING & COLLATERAL MANAGEMENT CONFERENCE
September 22-23, 2016 | London, UK
The conference will bring Beneficial Owners the latest information on the practice of Securities Lending as it relates to their programs and strategies. The programme will also address the critical elements of collateral and its management as it pertains to Securities Lending.
www.imn.org/eurosec16 | Email: amelvin@imn.org
Call: +1-212-901-0542

Industry Events

IMN European Beneficial Owners' Securities Lending Conference

Date: 22-23 September
Location: London

The IMN European Beneficial Owners' Securities Lending Conference will cover the 2017 macroeconomic outlook and implications for securities lending programmes; the economics of collateral optimisation; structuring and enhancing lending programmes to increase revenue; the business implications of regulation on lending and collateral management programmes; alternative routes to market; effective benchmarking and performance; sell and buy-side perspectives on doing business today; and perspectives on the future direction of the industry.

10th Annual Collateral Management Forum

Date: 21 October
Location: Amsterdam

The 10th edition of the annual Collateral Management Forum in Amsterdam is looking to offer an overview of the most crucial topics in the field today. In a shifting regulatory enivornment, with the margin requirements soon to come into play, the call for advanced tools of collateral management is as loud as ever.

For more events visit securitieslendingtimes.com/events/events.php

Industry Recruitment

Securities Lending Trading (Associate/Vice President)

Recruiter: BlackRock
Location: London

BlackRock is one of the world's preeminent asset management firms and a premier provider of global investment management, risk management and advisory services to institutional, intermediary and individual investors around the world. BlackRock offers a range of solutions—from rigorous fundamental and quantitative activemanagement approaches aimed at maximising outperformance to highly efficient indexing strategies designed to gain broad exposure to the world's capital markets.

Systems Analyst

Recruiter: EquiLend
Location: London

EquiLend is seeking a systems analyst for the London office to work closely with the EquiLend product owners and scrum team to execute projects from inception through production release.

Senior Software Engineer

Recruiter: EquiLend
Location: New York

EquiLend is seeking a senior software engineer to participate in all stages of development for several applications within the enterprise.

Business Analyst, Prime Finance

Recruiter: Citi
Location: Dublin

Investor services is a business line within markets and securities services, it includes products across prime finance, delta one, futures, OTC clearing, collateral management, global custody, fund administration, and agency lending.

Comings and goings at Elixium, CloudMargin and BNY Mellon

Stephen Malekian has joined platform provider Elixium as head of US business development.

The former Barclays and Citi executive will work on the development of Elixium's all-to-all lending marketplace in Europe and rolling out the business in the US.

Malekian ran global fixed income finance and prime services at Citi and Asian fixed income at Barclays. He has also served as chairman of the Securities Industry and Financial Markets Association's funding division executive committee, and been a member of the New York Federal Reserve Task Force on Triparty Reform and the European Repo Council.

Elixium launched its global peer-to-peer electronic trading marketplace earlier this year.

Malekian will join the likes of Nick McCall, Roberto Verrillo, Gabrielli Frediani, Nick Van Overstraeten and Iona Levine in bringing Elixium's platform to market.

CloudMargin has reinforced its global teams with a number of senior appointments in July.

Lisbeth Hadingham has joined the firm as head of sales for North America, along with Lee McCormack as head of product strategy.

The former FIS securities finance and collateral management executive joined financial technology provider CloudMargin this week. She is based in New York.

Hadingham previously worked at Citi in equity finance and J.P. Morgan in collateral management.

In her new role at CloudMargin, Hadingham will focus on expanding the technology provider's services in North America while continuing to focus on current clients.

Hadingham described her arrival at CloudMargin as the "natural progression" of its growth. Based in London, CloudMargin is also looking at to expand into the Asia Pacific toward the end of 2017.

"It's an exciting time to be joining CloudMargin given the significant challenges within collateral management at the moment," Hadingham added. "I'm looking forward to helping our current and new clients to deal with these challenges, while making their businesses more efficient."

McCormack, who will be based in London, brings more than 15 years of experience in trading, clearing and settlement from previous roles at Nomura, Morgan Stanley and UBS.

CloudMargin's latest appointments come only a few weeks after David Little joined as non-executive director, along with Lisbeth Hadingham who took on the role of head of sales for North America. She is based in the firm's recently opened New York office.

Jeannine Lehman is retiring from BNY Mellon at the end of the summer, the bank has confirmed.

Lehman is EMEA head of collateral management and segregation at BNY Mellon Markets, a role she took up in 2015.

Her responsibilities include driving business growth, product management, client relationship management, service delivery and regulatory issues.

Lehman is also a member of the EMEA extended executive and operating committees at BNY Mellon.

She joined the bank in 2003 and has held multiple roles, including head of securities finance in the EMEA.

A decision on Lehman's replacement will be announced in due course.

BNY Mellon has also appointed Hani Kablawi as head of investment services for Europe, the Middle East and Africa (EMEA).

Kablawi, previously head of asset servicing for the EMEA, will now lead the business strategy for investment services in the region. **SLT**

SLT
SecuritiesLendingTimes

Editor: Mark Dugdale
editor@securitieslendingtimes.com
+44 (0)203 750 6022

Deputy Editor: Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Reporter: Drew Nicol
drewnicol@securitieslendingtimes.com
+44 (0)203 750 6022

Contributors: Becky Butcher

Marketing Director: Steven Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6028

Designer: James Hickman
jameshickman@blackknightmedialtd.com
+44 (0)203 750 6028

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

Recruitment Manager: Chris Lafferty
chris@assetservicingtimes.com
+44 (0)203 750 6020

Office Manager: Chelsea Bowles
accounts@securitieslendingtimes.com
+44 (0)203 750 6020

Office fax: +44 (0)20 8711 5985

Published by Black Knight Media Ltd