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2016 and beyond

SIFMA bangs drum for the securities lending industry

The securities lending market is not a systemic risk and therefore should not be constrained by regulation, according to the Securities Industry and Financial Markets Authority (SIFMA).

In a response letter, dated 21 September, to the Financial Stability Board (FSB) on its proposals for addressing "structural vulnerabilities" in asset management activities, SIFMA asserted that "securities lending is helpful to the financial markets in a number of respects."

"Regulators should not take measures that would tend to limit securities lending activity."

SIFMA added that the volume of regulation already in place "adequately address any risks that may be associated with the practice".

The association also noted argued that the indemnifications covered by the FSB's are "well regulated and the potential liability is self-contained and limited to the difference between the replacement cost of the security and the value of the collateral pledged".

SIFMA's response letter focused on addressing what the FSB described in its policy recommendations published on 22 June as "structural vulnerabilities" in the activities of asset managers and investment funds.

As well as securities lending, SIFMA also responded to FSB's proposals on tackling leverage, operational risk and liquidity risk management. On the liquidity risk management proposals, SIFMA urged the FSB to ensure any additional reviews were

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strictly necessary and take existing regulation and market practices into account.

SIFMA also warned the FSB not to lose sight of the low risk that open-end funds pose when constructing future regulation.

"The FSB's call for additional liquidity tools is not commensurate with the risks posed by open-end funds. Therefore, we urge the FSB to refrain from pursuing these recommendations or, at minimum, delay consideration of these recommendations pending further action by national securities regulators."

On leverage, SIFMA endorsed the FSB's view that the use of leverage is not widespread, and therefore it is not "a source of systemic risk".

In assessing the FSB's overall approach to promoting financial stability in its comment letter, SIFMA stated: "We are encouraged by the FSB's shift in focus to asset management products and activities and away from its past initiative of establishing methodologies for identifying individual funds or asset managers as systemically important."

"We believe that this revised approach better reflects the fundamental nature of the asset management business, recognises the differences between asset management and other financial services firms, and better informs the FSB's approach to regulatory frameworks in US and non-US jurisdictions," explained SIFMA.

T2S on a roll with wave-three success

Wave-three participants have successfully migrated to the Target2-Securities (T2S) pan-European securities settlement platform.

Euroclear's Settlement of Euronext-zone Securities (ESES) central securities depositories (CSDs)—those in Belgium, France and the Netherlands—along with VP Securities in Denmark and VP LUX in Luxembourg, are all now up and running on the single platform.

This means that the T2S platform is now processing 45 percent of the total transaction volumes expected by the time migration is completed in 2017.

This latest wave represents the halfway point of the migration programme, intended to improve efficiency in in cross-border settlement in Europe. The first wave of CSDs went live on the platform on 22 June 2015, while wave two went ahead without a hitch in March this year.

The Euroclear ESES CSDs were originally scheduled to join the platform in wave two, but delayed the move, citing early processing challenges and requesting more time to prepare.

At the time, Euroclear suggested that the complications were already under control, but had slowed the process so far.

Tim Howell, CEO of the Euroclear group, commented on the wave three migration, saying: "The T2S project is a significant undertaking for Europe's financial community, bringing many opportunities for cross-border trading and enhanced liquidity management."

He added: "Reaching this milestone has taken tremendous motivation and commitment by many people at Euroclear and by our client community, and I would like to thank them for their efforts."

In a statement on the migration, VP Securities called the project the biggest in its history, "in terms of both value and significance". The CSD added that VP Securities has invested DKK 300 million (€40.3 million) in adjusting its systems to access the platform.

VP Securities is settling euro-denominated issues on T2S. However, it intends for the CSD to be the first to offer settlement in an alternative currency, with plans to settle DKK on the platform in 2018.

Niels Olsen, CEO of VP Securities, said: "As a CSD we're fully aware of the importance of an integrated European financial market. This made it natural for VP to be part of T2S, even though Denmark is not in the eurozone."

He added: "Harmonisation via the T2S project is one of the most important reasons for our participation."

"This harmonisation creates a level playing field for all CSDs, ensuring fair competition."

Wave four of the migration is scheduled for 6 February 2017, and the project is scheduled to be completed with a final wave in September 2017.

Homebuilders hammered by short sellers, finds IHS Markit

Homebuilders have been singled out by short sellers in the week of their earnings announcements, according to IHS Markit.

US retail construction firms KB Home and Lennar topped IHS Markit's list of highly-shorted firms with 21.8 percent and 5.7 percent of shares out on loan, respectively.

According to IHS Markit, both firms have seen consistently elevated levels of short interest since the financial crisis but shorting interest has dropped off in recent weeks.

"The covering accelerated in the wake of buoyant earnings from fellow homebuilder Toll Brothers which saw its shares jump significantly after announcing better than expected order volumes," explained Simon Colvin, research analyst at IHS Markit, in a research note.

"While the covering indicates that investors are less bearish on both firms in recent weeks, KB Home still has over twice the level of shorting activity it did at the start of the year."

KB Home suffered a 15 percent drop-off in its share price after it was revealed it had missed delivery targets in its Q4 earnings results.

IHS Markit noted that although the firm has since recovered from this fall, the shorting interest that it picked up along the way remains high.

IHS Markit also highlighted German real estate property company Immofinanz in the research note as the only other firm with more than 5 percent of its shares shorted leading up to earnings this week.

Immofinanz has a large exposure to Russia and Eastern Europe, which has made it a popular short in the last couple of years.

Banks are on track with Basel III capital requirements

Important financial institutions are largely meeting their targets for Basel III capital requirements, according to the Basel Committee on Banking Supervision's latest Basel III Monitoring Report.

The report included data from 100 large and internationally active institutions with capital of €3 billion or more, classed as 'group-one' banks, which will include some of the largest agent lenders.

It also used reports from 128 additional banks, classed as 'group two'.

As of 31 December 2015, when the minimum liquidity coverage ratio (LCR) requirement was set at 60 percent. Average LCR for group-one banks, however, was 125.2 percent.

For group-two banks, average LCR was 141.1 percent.

Of group-one banks, 85.6 percent already exceed the 100 percent final target, scheduled for 2019, after a staggered increase. Only one bank was not meeting the current 60 percent minimum LCR target. For group-two banks, 82.9 percent had an LCR exceeding 100 percent, and, again, only one bank fell short of the 60 percent target.

According to BCBS, the relevant national supervisory authorities have taken action with those banks that missed the target, in order to correct the problem.

Results were similarly positive for the net stable funding ratio (NSFR) requirement.

Average NSFR was 113.7 percent for group-one banks and 115.9 percent for group-two banks, well in excess of the target levels of 100 percent.

Of group-one banks, 79 percent either met or exceeded the 100 percent minimum, as did 87 percent of group-two banks.

Almost 96 percent of group-one banks were found to be close to meeting the target, with NSFRs of 90 percent or more. This was also the case for 97.2 percent of group-two banks.

The 100 percent NSFR will become a minimum standard on 1 January 2018.

Lombard Risk reveals two new collateral offerings

Lombard Risk has bolstered its stable of offerings with two new collateral products focusing on tackling challenges around margin calculations and management, set to be available in 2017.

The first of these offering is AgileCollateral, a cloud-based collateral management system that provides the functionality of its existing flagship Colline solution “in a modular, light touch delivery format”, according to Lombard Risk.

The new offering is described by Lombard Risk as a “collateral-in-a-box solution” that eliminates the need for onsite installation and infrastructure costs.

It will be aimed at servicing asset managers, buy-side brokers, pension funds, corporates and investment firms that must soon meet the stricter uncleared collateral margin requirements expected to be phased in from around March 2017.

In a statement on the launch, Lombard Risk stated: “It can be up and running in as little as a day. It is intuitive, reducing the need for training, and modular, adding asset classes as needed, scaling up over time to handle more complexity and volume, and implemented in layers to control costs to match business needs.”

The solution provides direct connections to electronic messaging services and its optimisation algorithms. It also provides security through the elimination of spreadsheets, and mitigates risk associated with manual input and calculations, according to Lombard Risk.

It can be delivered through either a licence or subscription fee model.

Alastair Brown, Lombard Risk’s CEO said: “Buy-side firms face numerous collateral challenges particularly as they have to meet new regulatory requirements expected to be phased in around March 2017, which will see margin requirements and liquidity ratios increase. This means they must look at new ways to meet these challenges while keeping control of headcount, minimising fixed cost increases and reducing the impact on fund performance.”

“AgileCollateral gives a greater level of control over operational processes due to its rapid implementation, flexible pricing models and low cost deployment options.”

“This allows firms to reduce the high cost of collateral management and redirect resources to better serve investors.”

The second offering is a hybrid product that is also based on the Colline solution but incorporates TMX Market Insights | Razor Risk to form ‘Colline Calcs’.

This joint product includes margin calculation and analytics solutions by useing multiple internal or industry standard calculation models and takes into account existing portfolios and offset benefits as well as reducing the costs of sourcing eligible collateral.

It also allows clients to validate the estimated margin calls from the central counterparty (CCP), according to Lombard Risk.

Clients can make pre-deal calculations within Colline ensuring effective risk measurement and control for improved profitability and efficiency ratios.

Global securities financing and collateral management solutions

- Optimize funding and collateral decisions
- Reduce counterparty and operational risks
- Enable efficient and high-growth operations
- Meet regulatory and market requirements

Helen Nicol, global product director for collateral solutions of Lombard Risk said: “The ability to obtain real-time initial and variation margin calculations for the validation of external or counterparty/broker/CCP marks will radically change the way our clients operate, providing greater analytics and perspectives for a competitive advantage.”

“We believe the partnership between Lombard Risk and Razor Risk provides an industry leading solution that gives greater accuracy and certainty in managing collateral margins and calculating solvency ratios.”

Peter Walsh, global head of sales, TMX Market Insights at Razor Risk said: “With Colline Calcs, financial services firms can make pre-deal calculations from within Colline providing effective risk measurement and control for improved profitability and efficiency ratios. We are pleased to formalise our relationship with Lombard Risk and look forward to bringing our offering to market.”

BNY Mellon to begin testing real-time payment service

BNY Mellon has upped the ante in the race to achieve efficient real-time payments by becoming one of the first participants to incorporate the Real-Time Payment (RTP) system being developed by The Clearing House (TCH) into its clearing infrastructure.

According to BNY Mellon, it plans to use the RTP system to facilitate real-time payments on behalf of both corporate and bank clients, and to leverage the system’s capabilities in support of other in-house payment innovations.

RTP will be available in the US in the first half of 2017.

“We see the availability of real-time clearing and settlement as one of the most significant advances in payment technology in more than 40 years,” said Michael Bellacosa, managing director and head of global payments for BNY Mellon’s Treasury Services business.

“Payment innovations have to pass three key tests—reliable and repeatable global standards; sufficient levels of ubiquity and network effects; and regulatory buy-in.”

“Being designed to satisfy all three criteria, RTP system promises to add an important new dimension to our clients’ payment experience.”

Russ Waterhouse, executive vice president, product development and strategy for TCH, added: “The participation of our member banks is critically important to the success of our real-time payments initiative.”

“BNY Mellon’s commitment to bring RTP system to market reflects the high level of leadership the company has demonstrated from the outset of the project, and their ability to provide real-time payment support as part of their outsourcing services for client banks represents an important network effects multiplier.”

GSX gains HMRC recognition

The Gibraltar Stock Exchange (GSX) has been acknowledged by the UK’s HM Revenue & Customs (HMRC) as a ‘recognised stock exchange’.

The new designation extends to the entire exchange and will allow GSX to expand its services and offering to issuers relating to asset-backed securities and derivatives securities. The decision, confirmed by HMCR’s board, follows recognition of GSX by European Securities and Exchange Commission in March 2015.

HMCR’s recognition formally comes under section 1005 (1) (a) Income Tax Act 2007.

Nick Cowan, managing director of GSX said: “GSX’s growth, as an EU regulated

market, has been built on providing a robust prospectus approval and listing process that is so fast to market, commercially attractive and well-regulated for issuers of debt securities, including corporate bonds, asset-backed securities, insurance linked securities, convertible bonds, and derivative securities, along with issuers of shares in funds."

"Our clients have asked GSX to seek this to have an alternative to the current listing venues for the listing of debt securities and funds and we look forward to further growing the business of the exchange."

itBit team launch blockchain firm

The team responsible for cryptocurrency trading platform itBit has now launched Paxos, a blockchain technology firm.

Paxos's flagship service, Bankchain, is a cloud-based platform-as-a-service solution that promises to transform post-trade market infrastructures and back-office processes for its global clients.

Previously, Bankchain was under the itBit umbrella, but it will now come under the Paxos brand.

Paxos's management team is led by CEO and co-founder Charles Cascarilla. Its board of directors includes former chair of the Federal Deposit Insurance Corporation Sheila Bair and former senator Bill Bradley.

Former chair of the Financial Accounting Services Board Robert Herz and former chair, president and CEO of Lotus Development Corporation Jim Manzi will also hold board positions.

"Increasingly, the financial services industry is embracing the transformative potential of blockchain technology. Paxos is making that potential a practical reality," said Cascarilla.

"Our collaboration with Euroclear to create a trusted blockchain settlement infrastructure for gold is just the beginning, and an important first for the industry."

Saxo Bank digitises corporate and government bond trading

Denmark's Saxo Bank has launched its new digital bond trading solution for corporate and government bonds.

According to Saxo Bank, the new solution utilises its relationships with liquidity providers in bond markets while also using new technology products. It will offer access to over 5,000 investment-grade and high-yield corporate and government bonds from around the world, and in 20 currencies.

Bond orders will be directed to an 'optimised dealer' auction with up to 40 liquidity provider participants, with most trades completing within a matter of seconds.

The competitive multi-dealer platform means clients could see savings of up to 30 basis points for corporate bonds, and between 5 and 10 basis points on government bonds.

It also means both retail and institutional investors will gain more direct access to fixed-income trading opportunities, more transparently and efficiently.

The platform will be initially rolled out on SaxoTradeGO, which is the bank's multi-asset trading platform.

Kim Fournais, CEO and co-founder of Saxo Bank, said: "It is hard to imagine a market which is more ripe for disruption than the bond market."

"Watching a bond trader trade over the phone, at a time when the internet has touched almost every area of financial markets, not to mention our lives, is a clear call for disruption."

"Investors need to ask themselves if they want to continue to trade based on an indicative price from a single bank or if they want to get the best price available from more than 40 global bonds providers, including some of the largest global banks."

Simon Fasdal, head of fixed income trading at Saxo Bank, said: "I am proud that the next step in Saxo Bank's history of democratising trading and investment is to truly digitise bond trading."

"Client demand and regulatory pressure makes transparency absolutely key and with our new offering we will charge a commission, offering full transparency to clients, in contrast to the industry standard of a spread based system, which is not always a transparent way of pricing clients."

EU regulators dismiss amendments

Three European regulators have joined forces to voice their disagreement with the European Commission's proposed amendments to the final draft regulatory technical standards (RTS) for over-the-counter derivatives.

The European Banking Authority (EBA) along with the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority have rejected the commission's proposal to remove concentration limits on initial margins for pension schemes, claiming that these are crucial for risk mitigating.

The European supervisory authorities (ESAs) also recommended that further clarity was needed regarding non-centrally cleared derivatives concluded by central counterparties that are not covered by this regulation.

In a statement on the joint opinion, the EBA noted that ambiguity in this area has been a "source of concern for stakeholders".

Further details are also needed for the application of the RTS to transactions concluded with third-country counterparties, particularly non-financial counterparties.

Additionally, the ESAs highlighted a contradiction between the commission's proposed additional condition for covered bonds and the European Market Infrastructure Regulation (EMIR).

Specifically, the amendment would have the effect of ranking derivatives counterparties after bond holders, which is contrary to the reasoning established in EMIR to grant preferential treatment to cover bonds.

Finally, according to the ESAs, a number of wording changes proposed by the commission require amendments as they may lead to a different application of the provisions compared to their original text of the RTS.

ICAP and MTS add Spanish repo index

ICAP's global fixed income trading platform BrokerTec has partnered with MTS, a European fixed income platform, to add a Spanish repo index to its RepoFunds Rate (RFR) indices.

RFR offers series of daily European indices covering the German, French, Italian and pan-Europe repo markets.

According to ICAP, each RFR index accurately reflects the effective cost of repo funding for trades executed on the BrokerTec and MTS electronic trading platforms.

The RFR, which launched in 2012, is based on four guiding principles: it is trade backed; has a transparent methodology; is replicable with repo transactions; and has independent governance and trade sources.

It follows the IOSCO principles for financial benchmarks and was developed to be the first index to fully reflect the effective cost of secured funding in key eurozone countries.

The addition of the Spanish repo index follows the introduction of sterling repo index rate in April 2016 for UK gilt repo.

Daily trading volumes sit at €230 billion per day between the two groups.

Miami bound

RMA's director of securities lending, Fran Garritt, gives the industry a flavour of what it can expect from the association's 33rd securities lending conference

This year's conference will kick off with an update from RMA and SIFMA. Can you give us a preview of what to expect from that?

I like to use the association update session of the conference to highlight the work that the Risk Management Association's (RMA) working groups have done over the past year. This year I'd like to draw particular attention to the work of RMA's new tax committee, which is led by George Rapalje from State Street. Since the last conference, that committee has submitted two comment letters to the Securities and Exchange Commission, on 28 March and 31 August. This committee has done good work in communicating with the US tax authorities on new US tax regulations and administrative guidance issued under Section 871(m). RMA in general is a resource to regulators as they draft guidance for the industry. For example, it has also had discussions with the Federal Reserve as it prepares its final rule on single-counterparty credit limits, which will have a big impact on all banks, but especially custody banks.

One of our biggest successes recently has been the progress made in reforming the Basel Committee on Banking Supervision's standardised approach for credit risk over the past 18 months. We initially submitted a very extensive comment letter to the BCBS's original proposals and from that you can see that a lot of those revisions have been taken on board in the second iteration. They took a lot of our ideas seriously and we are pretty happy with where this is now. There were, of course, several other associations that contributed to this positive result for the industry, but we are pleased with our contribution to this conversation. State Street's Glenn Horner, who is chair of RMA's securities lending committee, was instrumental in the the association's work on this issue and represented us with several regulators.

There will be a lot of familiar topics on this year's agenda but some areas have seen significant developments since we last met in Miami. Which sessions do you feel are most topical this year?

There are two significant initiatives that will undoubtedly take up a large share of the focus during the conference. The first is ICAP on 30 September ceasing to publish the federal funds open rate, which has been the standard in the US for securities lending pricing. It has been decided that the Federal Reserve Bank of New York's new overnight bank funding rate (OBFR) would better address the benchmark standards recommended by the International Organization of Securities Commissions. The OBFR will take over on 3 October, just before this year's conference (10 October to 13 October), making it very topical.

The RMA has been very involved in this process. We've met with the treasury market practices group members several times and we've held monthly calls to ensure everyone is moving over smoothly to the new standard.

Directly following the conference we have money market reforms kicking in on 14 October. This area is represented on our Wednesday agenda as all the sessions tie in together to address this topic. It affects many people so we wanted to allow it to have enough time during the conference to be discussed properly.

Thursday's programme will include various trading and counterparty strategies for the industry going forward.

What issues do you that you feel RMA should raise awareness about? Which panels address these issues?

The conference co-chairs Patrick Morrissey from Vanguard and Mike Kelleher from J.P. Morgan and the steering committee put together a program that is very relevant. The Tuesday agenda focuses on legal and regulatory, as well as the operational side of things. The legal and regulatory portion will include capital and liquidity issues as well as the resolution stay protocol. The operational agenda will include a discussion of blockchain, which is obviously the topic of the moment. This will feed into a conversation about market transparency and the wider availability of data, which is hugely important for the market going forward.

However, with the regulatory deadlines coming up so soon I'd have to say that the whole of the Wednesday session is probably the most important to cover, given the timing.

Are there any other topics you expect to come up?

Yes, indemnification and central counterparties (CCPs). The conversation around indemnification has come up a lot this year and I know the landscape around this feature has changed substantially in recent months. Regarding CCPs, the industry still has challenges to resolve to place securities lending transactions through CCP clearing. I'm sure both issues will be a topic of discussion in various panels. **SLT**

Taking stock

Tred McIntire, formerly head of Goldman Sachs Agency Lending and a member of the RMA executive committee, gives his thoughts on how the securities finance industry has developed during his long tenure

How does it feel to retire after 30 years in the securities lending industry?

It was at last year's Risk Management Association (RMA) Conference on Securities Lending that it really hit home. I have been working with many of the people at the RMA for more than 15 years and so I had mixed feelings about attending my last RMA conference.

I had been with Goldman Sachs for more than 30 years and hadn't taken more than two weeks vacation at a time, so I was really looking forward to taking a longer period off and spending time with my family.

What were the highlights of your experience with the RMA conference?

One of the main highlights was chairing my first conference for the International Securities Lending Association (ISLA) and RMA, as well as joining the RMA executive committee in 2002, and later serving as its chairman.

What are some of the defining moments of the industry's development that you have witnessed?

For the wider industry, a key point would be the increased transparency that came about with Data Explorers (now IHS Markit) entering the market and introducing products that focused on performance measurement.

The 2008 financial crisis was obviously also a major turning point with the disappearance of Bear Stearns and Lehman Brothers. It was a difficult time for the industry and many individuals. Although a lot of beneficial owners scaled back their involvement in the lending market, and some dropped out completely, I think it was also an opportunity to forge even stronger relationships between lending clients and borrowers.

Dealing with the aftermath of the financial crisis and all of the resulting regulatory changes has been an interesting endeavour to say the least. Regulatory awareness has heightened across the entire industry, and everyone has focused on risk management and minimising exposures.

A positive result has been that the changes in the regulatory environment have driven borrowers and lenders to work closer together, with the help of organisations such as the RMA, ISLA and the US Securities Industry and Financial Markets Association. There has been a lot of constructive dialogue since the crisis with the regulators and among the different firms.

A few other key points of the industry's development I would highlight would be the new requirement that most agent lenders have to set aside capital for indemnification–that really is a huge change. Also, the steep decline in money market yields and the resulting decrease in general collateral lending had a significant effect across the entire market.

Finally, all the 'new' markets that have entered the securities financing market in the past few years, such as South Korea, Taiwan and Brazil, can all be considered major developments in the industry's development. The sheer growth of the market in such short space of time is one of the main differences I notice when I look back.

Was 2008 one of the most dramatic moments of your career?

Well, maybe, but it was also a year of record profitability for some in securities lending. It was definitely an inflection point in the market's history. It was the point where everyone realised that things need to change in a major way.

A lot of the regulation has come since then, and, although it has been difficult for market participants to deal with, it will ultimately force people to focus on risk management. Efficient investment of cash collateral and retaining appropriate liquidity, for example, are just some of the basics that were forgotten in the hunt for more and more profits pre-crisis. The crash brought many back down to Earth.

Whenever we see difficult times, I see it as an opportunity to work closer with clients. When you get through the tough periods, you end up with stronger working relationships that will benefit everyone involved. However, it is still unknown what some of the unintended consequences of all this regulation will be. On the fixed income side, there are questions about how liquidity in the corporate bond market will be affected.

There are already changes in the repo market and I've even heard cash described as a 'problem asset', which would shock a lot of people if you had said that 10 years ago.

The regulation is very expensive to comply with and has undoubtedly caused a lot of internal change and diverted resources that are already stretched. But, like all markets, we have to evolve and seek out new opportunities in the new environment.

How have beneficial owners' views on securities lending changed during your time in the business?

Broadly, lenders are now much better informed about how the market works than they were 10 to 15 years ago. Furthermore, the growth in third-party lending and unbundled programmes is another key development for beneficial owners. Even the largest custody lenders are now involved with non-custodial lending.

We have also seen more 'hands-on' involvement from clients in managing how their individual programs are run. The growth in lender-defined parameters is a relatively recent change that was driven by beneficial owners having a more sophisticated view on the market. Limits on average-daily trading volumes, minimum spread criteria and more conservative cash pools are also all consequences of lenders taking a more hands-on approach to their lending programmes.

What areas of development does the industry need to prioritise in order to keep moving forward?

Investment in technology has to be a key part of any solution going forward. Ultimately, a lot of the new investment and strategy planning will have to be shaped by the regulation coming down the pipeline. There are still a lot of open questions about how the regulation will affect market functionality in a stress scenario.

It will also be interesting to see what impact the new president has on regulation, and whether there is a shift of power in Congress in the US.

What will happen to liquidity? Will the same set of lenders continue to offer supply in the market? Will the borrow landscape change significantly? How will collateral change in the US? Collateral in the US is still very much dominated by cash but that's shifting to non-cash, so will that trend continue or shift back when interest rates go up?

It seems like the approval of equities as collateral in the US is imminent, however, I think that was true 12 months ago. A related question is which beneficial owners will move forward in accepting equity collateral.

All of these unanswered questions make long-term planning difficult.

What's your prediction on dominant industry topics for the future, such as CCPs? Do they have legs?

The debate around central counterparties (CCPs) has been going on for years and will continue for a while. It's still unclear whether the market will ever accept CCPs and commit to putting significant business through them.

Equilend's recent acquisition of AQS should certainly improve its ability to offer access to the Options Clearing Corporation's CCP to its customers. It will be interesting to see how quickly Equilend can integrate the AQS technology into the rest of its products and bring a CCP offering to market.

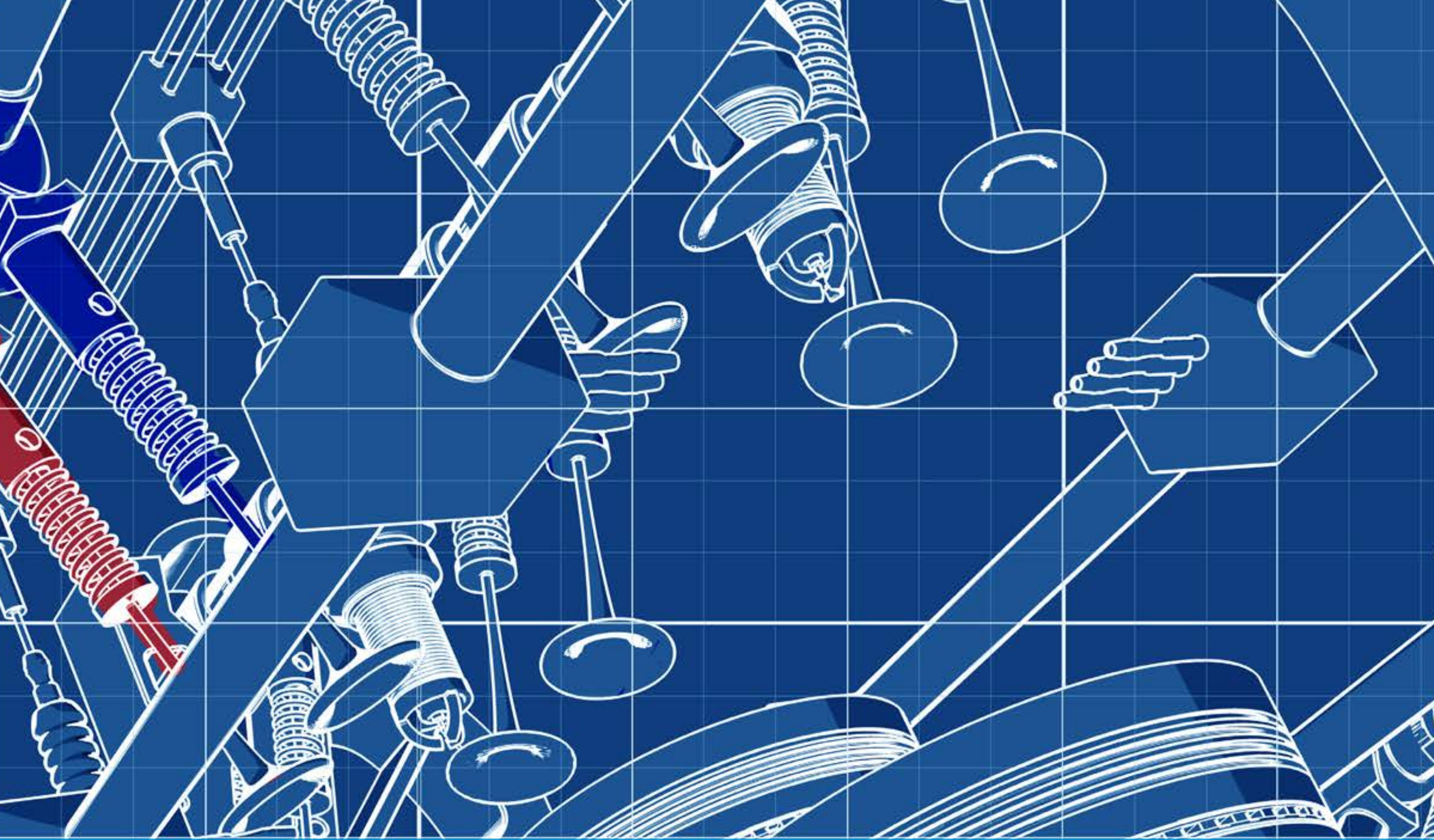
Everybody seems to hope that CCPs will end up being the silver bullet to a lot of the regulatory issues. However, once again there are still too many questions without answers.

The CCP models we have just aren't defined enough on a number of issues that need a workable solution before the market and the regulator will accept them. **SLT**

> ***It seems like the approval of equities as collateral in the US is imminent, however, I think that was true 12 months ago***

Tred McIntire, Former head of agency lending, Goldman Sachs


we lead
the way



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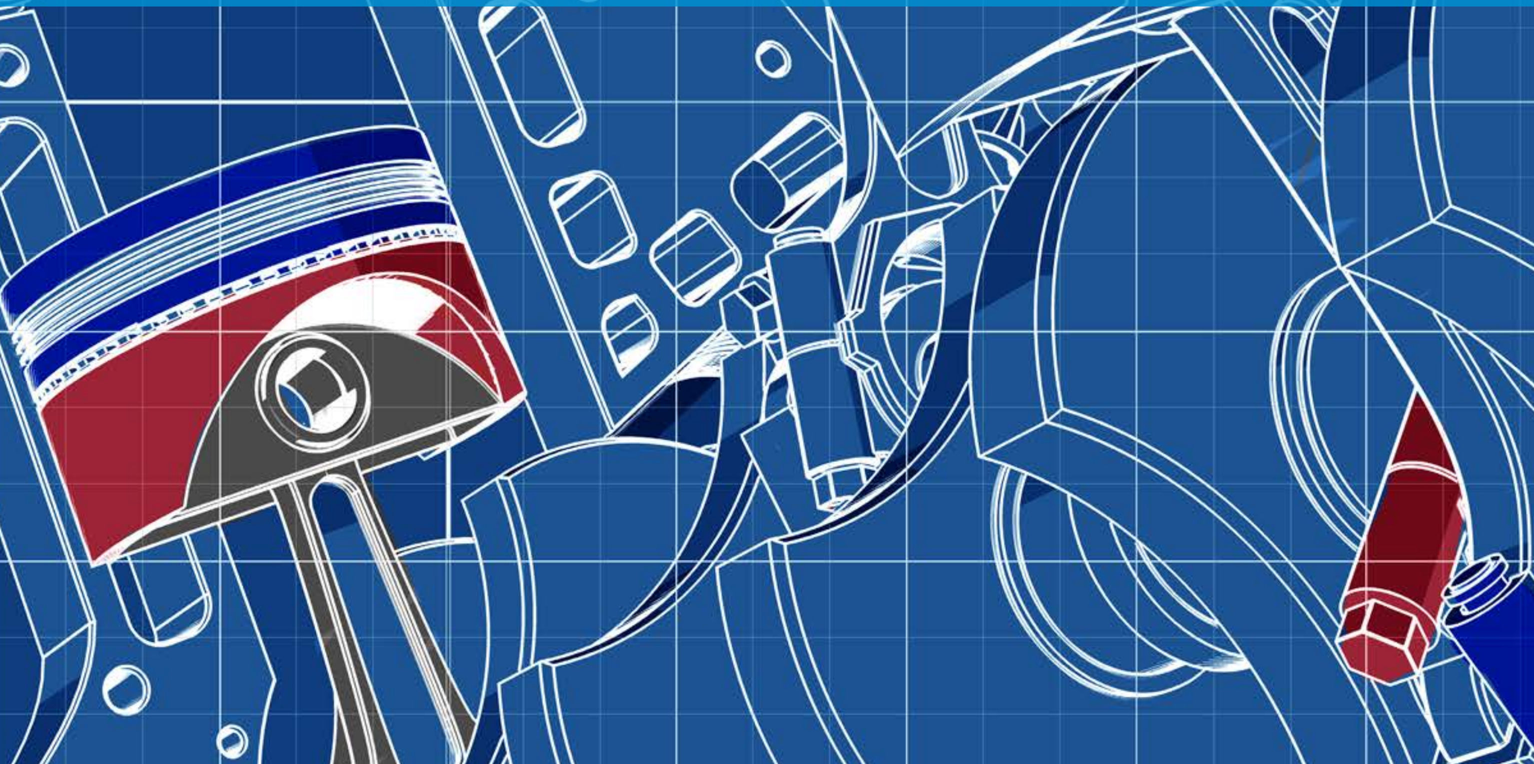
It’s a tough regulatory and cost environment, but through innovation, collaboration, and adaptation, securities borrowers and lenders are learning to optimise



Where and how are securities lenders and borrowers optimising their collateral?

Stuart Abraham: There definitely appears to be an opportunity for those with the balance sheet capacity and appetite for agency lending desks with the right technology to help the givers and takers of cash to optimise their activities, by helping them across all their derivatives activity. Whether cleared or uncleared, they can generate cash quickly and cheaply through reverse repo and clever and efficient selection and movement of securities. On the one hand, they are minimising the funding costs to meet their initial and margin requirements, and on the other, they are helping maximise returns on any non-cash collateral they hold that they may not have been making best use of up until now, and arguably need to very quickly find ways to mobilise this. Cash may be king, but for how much longer?

Tracey Adams: Considering the conceptual buzzword that collateral optimisation was five years ago, most institutions have now recognised the scale of the post-regulation collateral challenge and have embarked on the collateral optimisation journey. Certainly most securities lenders and borrowers will have some sort of optimisation tool to manage collateral requirements through the use of their current assets. That said, the degree of complexity around optimisation varies from institution to institution and I envisage that there will be an ongoing effort to improve the way in which optimisation tools work, mainly around inputs (data feeds) and algorithmic complexity. Outside of optimisation, at Lombard Risk we are also seeing a re-emerging focus on collateral transformation and a growing interest in the use of money market funds as instruments of collateral.

Michael Albanese: As regulations evolve, collateral providers are defining 'optimal' on an increasingly individual basis. Previously, optimal would typically have been the cheapest to deliver, or similar. Now, what is optimal differs for each institution, given its unique binding constraints. As a result, collateral providers need better tools to understand their intraday collateral allocation and increasingly want to be able to customise their optimisation parameters.

We believe the increased complexity is creating greater demands on all parties and requiring stronger partnership between the collateral agent and its clients. For example, our clients have asked for sophisticated allocation options that will allow them to allocate specific collateral to specific counterparty accounts for a defined period of time. We call this 'client-defined allocation', and it gives providers a tremendous amount of control and flexibility while meeting collateral takers' eligibility, haircut and concentration rules. Not surprisingly, those rules have become more detailed in response to market and regulatory changes.

Ted Allen: Many of our securities lending clients leverage the capabilities of the latest generation of collateral optimisation systems to implement automated processes for optimising collateral allocation. This requires a consolidation of inventory, preferably in real time, and configuration of optimisation algorithms to consider the optimal sourcing of the assets across lenders and internal desks. Collateral transfer pricing models work as inputs to the collateral optimisation, to automate the booking of loans and borrows between collateral consumers and providers, and ensure the cheapest overall funding cost for collateral.

Martin Seagroatt: Securities finance has become a key function for optimising collateral in recent years. As a result, one of the market trends we are seeing is a need for global inventory management projects. This is an important first step in collateral optimisation. Once a firm has a clear real-time view of global inventory, including pending and settled positions, it can then start to integrate this with

Tracey Adams
Regional head of APAC Colline
Lombard Risk

Martin Seagroatt
Marketing director, securities financing and collateral management
Broadridge

Pierre Lebel
Head of collateral advisory
Societe Generale Prime Services

Michael Albanese
Managing director, global head of collateral management
J.P. Morgan

Stuart Abraham
European head of sales
CloudMargin

Ted Allen
Director of business development
Apex Collateral, FIS

its exposures across business lines and its collateral agreements and schedules.

This makes it much easier to take a forward-looking view of future collateral requirements. From there, the firm can more easily identify internal and external sources of collateral, unlock idle assets and then mobilise them to where they are needed. This provides a valuable tool for forecasting liquidity supply and demand, responding to client needs and meeting the requirements of Basel III liquidity coverage ratio (LCR).

The next step is to assign costs to collateral assets and ensure, for example, that securities trading special aren't used to collateralise trades where lower cost collateral could be used instead. This co-ordination between the securities finance and collateral desks, driven from a single global view of inventory can provide huge benefits. Key to this is an integrated securities finance and collateral management solution.

Automated proposals of cheapest-to-deliver assets for collateral usage is the logical progression from this, along with automation and optimisation around collateral recalls and substitutions. For some firms, more complex algorithmic optimisation can provide additional benefits.

For the buy side, identifying optimal collateral to pledge against derivatives transactions is a key requirement. Holding large amounts of cash for variation margin is not desirable for the buy side, due to the drag on returns it creates.

Locating non-cash assets for margin, and potentially transforming these into cash via securities finance trade structures, is also an important part of optimisation for buy-side firms. Likewise, the ability to handle the complexity of non-cash collateral can allow non-cash to be pledged were appropriate. Once these derivatives collateral needs have been met, the firm can then look at excess long inventory that it can finance to increase returns.

How hard up are desks? Are they squeezing enough from their reserves? What more can they do?

Abraham: You'd have to have been living under a rock to not have noticed that margins are being squeezed, balance sheets are shrinking and desks are struggling with spiralling costs of legacy infrastructures and falling volumes and revenues. What more can they do? Well everyone is trying to do more with less, optimising the use of scarce resources and maximising the returns when the opportunity arises. There is an argument that simply judicious use of cash and non-cash collateral is yielding significant enough returns without huge expense on complicated algorithms and models to identify the cheapest to deliver assets.

Add to this optimal use of collateral by consolidating into a single view all of your margin obligations across all the asset classes that you are active in, and across all the counterparts you have a relationship with, and combine this with a single view on your complete available and eligible cash and non-cash collateral inventory. That way you can meet those obligations, maximising returns and minimising costs. Are people doing enough? Probably not. Are there tools that exist to help them do more? Yes, absolutely.

Adams: Basel III's LCR and net stable funding ratio (NSFR) have and will continue to squeeze desks. As the cost of collateral increases and the requirement to hold increasing amounts of unencumbered high-quality liquid assets (HQLAs), that is, high liquidity and credit quality, is introduced, many banks are having to adapt. In terms of post-trade measures, what forms the strength and backbone of an institution's ability to manage collateral pressures is the further centralisation of inventory and liquidity funding functions across desks or products. This gives firms a view on forecasting, maturity ladders and funding diversification, which will in turn allow for greater opportunities around optimisation and less liquidity wastage. In terms of doing more, institutions are now also looking at pre-trade optimisation, adopting more stringency around portfolio analysis, stress testing and what-if analysis. Additionally, institutions are looking at different trading strategies such as 'evergreen' structures, which allow dealers pre-optimising capabilities.

Albanese: While we aren't necessarily seeing the collateral 'squeeze' that was discussed a few years ago, we do see significant changes to how desks behave. A lot of the traditional silos have been broken down as desks manage their activities, collateral, and capital more holistically on a global level.

This manifests itself in a number of ways. For example, many firms are rationalising their legal entities in order to manage local activity, increasing their ability to address fails with local in-market substitutions. Cash borrowers are increasingly interested in deploying collateral held onshore in local markets and are pushing for more onshore liquidity. And finally, we see a trend of sourcing collateral internally before it is deployed externally.

Allen: Many firms turn to us as technology providers to help with optimising inventory utilisation. In certain cases, global centralisation is not always effective or possible due to barriers between business and geographical silos. Creating a centralised technical and organisational environment can be key to reducing overall collateral costs, but these natural barriers can be difficult to overcome. Some examples of these difficulties come from an inability to optimise across CCPs, triparties, bilateral counterparties and regulatory buffers. We have seen clients make significant cost savings when considering all of these requirements holistically.

Seagroatt: The continuing low-interest rate environment and quantitative easing programmes are reducing opportunities for market participants. However, this will not carry on forever and firms need to position themselves for when rates do rise again.

Regulatory change is also causing cost pressure. This is leading to a close examination of how operating costs can be reduced to maintain profitability. Minimising collateral costs through optimisation is one way to do this, along with a more sophisticated analysis of balance sheet, liquidity and capital consumption for given trading activities.

A more holistic view of the costs of servicing customers across different business lines is also leading firms to quantify which clients are consuming liquidity, balance sheet and capital, compared to the value they generate.

Firms are also seeking to reduce costs by replacing multiple IT systems that have been bolted together over the years with a single system solution to rationalise IT spend. Hosted solutions can also offer benefits in reducing IT footprint.

Are you seeing any specific regulatory requirements on collateral have unintended consequences?

Abraham: Staggering implementation of the same rules in different jurisdictions is never going to yield positive results.

There have definitely been moves afoot to shift trading relationships to entities outside the immediate scope of the first regulatory go-lives in the US and Europe. It's further splitting liquidity pools, influencing who trades with who, and ultimately driving costs up further. The regulatory intent was to make trading of derivatives safer and more transparent, not necessarily more expensive.

Adams: Absolutely. If we look at the European Markets Infrastructure Regulation (EMIR), Dodd-Frank, the Basel Committee on Banking Supervision and International Organization of Securities Commissions, the growing demand for high grade collateral and the challenges around collateral mobility has resulted in balance sheet constraints. Equally, if we look at the Solvency II Directive, the need for insurance companies to hold assets for use as collateral may negatively impact investment performance. Finally, it is apparent that there is an impact around the risk profiling rules for intermediaries under the second Markets in Financial Instruments Directive II, and a direct consequence on trading in relation to the amount of liquid assets that must be put aside. All of these components have resulted in market players recognising the need for a wholesale change—not only around collateral itself but also around the fundamentals of trading strategies.

Albanese: Yes, and in some very interesting ways. One positive unintended consequence is the re-emergence of the triparty structure. Triparty offers the flexibility to address a variety of new uses and requirements. For example, with new rules governing non-cleared derivatives, triparty has proven useful for managing segregated initial margin requirements. The structure is well-suited to the controls required by both collateral providers and takers.

A second consequence is the necessity of managing collateral intraday. This requires greater intraday transparency into collateral, along with a nimble collateral substitutions capability that enables quick access to it. Intraday substitution, without the need for credit to start the process, has become a game changer. As trading counterparties face uncertain costs, the ability to substitute collateral with other eligible collateral, without the need for intraday credit, creates significant opportunities.

Pierre Lebel: The T+1 settlements of the variation margin (VM) in the uncleared margin rules comes to mind. The 'time tax' it creates can be described as follows: T+1 means Japan won't be trading with US anymore, as their T+1 is closed when the US opens 14 hours later. The only way around this is going through a custodian or a clearing broker, ensuring accounts are pre-funded, which has a cost. Once EMIR imposes the same T+1 to everyone early in 2017, this T+1 is likely to have a silo effect that will reduce liquidity, which runs counter to global regulatory objectives.

Allen: The leverage ratio has a significant impact on capital costs. This has put a break on the market for collateral upgrades or transformation trades due to the capital costs. Divergence in the measurements of the ratios under US and EU rules mean that much cash is now being provided by the European banks operating under a more favorable regime.

Seagroatt: Rules around segregation and rehypothecation have the potential to create unintended consequences further down the line.

This could lock up collateral at precisely the time it is needed most as collateral requirements increase globally. Differing regulatory regimes across jurisdictions and shifting timelines also create complexity and the potential for arbitrage.

The granularity of forthcoming Securities Financing Transaction Regulation requirements around collateral presents additional challenges for institutions. However, it is hard to tell whether regulators will be able to make any sense of the mass of data they are collecting. It is debatable whether this data will help regulators to identify build-ups of systemic risk and help to prevent future crises.

Finally, individual regulations have an effect, but it is the combined impact of all of the different rules across regulatory regimes that can really magnify the potential for unintended consequences. The result is that certain trading activities that underpin markets may become uneconomical, with a resulting reduction in global liquidity and other consequences that lead to different types of systemic risk.

Where would you like to see regulators tweak or re-write collateral rules?

Abraham: The elements of the new regulations that appear to cause the most issues are:

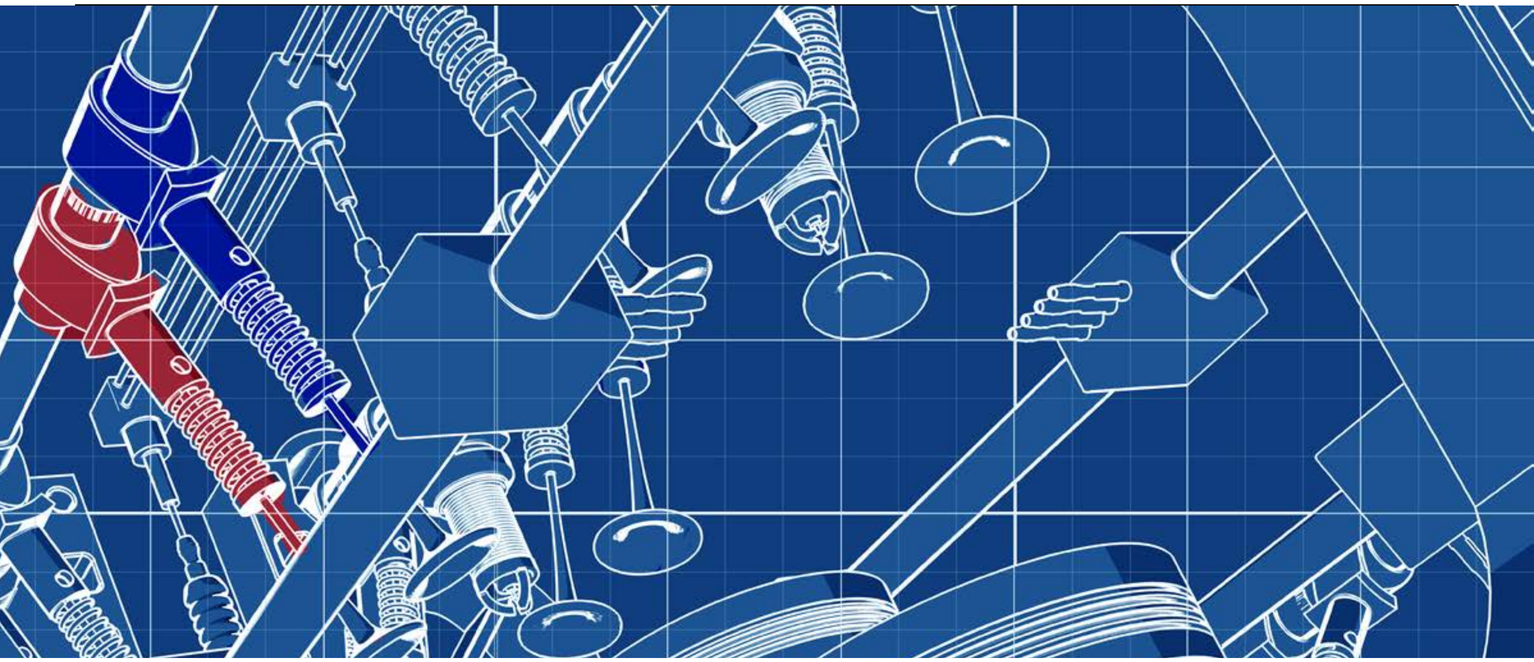
- Zero threshold;
- Monthly treasury average of less than €500,000 or $500,000;
- Daily margin calculations; and
- Same day settlement of margin calls. Article 13(1) VM rules in the current European regulatory technical standard stipulate that VM must be collected within the business day of the calculation, unless certain conditions are met—based upon whether the counterpart is moving regulatory initial margin.

I'm not sure it's the detail that is necessarily the issue, more the approach. I fail to see what benefits there are from tinkering with or rewriting the rules. But I have long been a proponent of a more harmonised approach across the different legislation, such as capital rules, clearing mandates and electronic trading. This for me is the fundamental difference between the US and EU approaches—a single piece of legislation introduced at the same time phased across the market covering all those areas rather than the broken disparate approach seen in the EU and elsewhere. That way, maybe some of the unintended consequences could have been, or can be, avoided or resolved in the future.

Adams: The principles upon which the regulations were built serve the right purpose, which is to put financial institutions in a position where they can survive large market shocks. Rather than asking the question of where we would like to see regulators re-write or tweak collateral rules, I think a more forward-looking view should be sought in how to improve the way regulations are introduced. Improvements in consultation mechanisms, both within the industry and with the regulators, are important to enable the meeting of theory and practice. Likewise, regulators working in specific jurisdictions ought to be mindful of other cross-border regulations that will affect their own capital market framework. Finally, timelines need to be realistic and adhered to in order for the industry to maintain focus.

Lebel: I would like to see the regulators tweak capital rules, particularly the leverage ratio, not so much the collateral rules. I find it a little strange to see on one hand the needs for collateral explode because of the regulation, and on the other hand the cost of the repo business explode because of the regulation as well. Intuitively, one would have thought it logical to see all businesses facilitating collateral moves and velocity being helped, instead of being taxed in some way. Similarly, why authorise variation margins to be deposited in securities, and at the same time differentiate the regulatory treatment of these margins versus the cash ones? We should at least allow financial counterparts to switch securities to cash without leverage cost?

Seagroatt: What we hear from customers is that different regulations haven't been aligned well across jurisdictions, which creates complexity. Also, some rehypothecation of collateral is not necessarily a bad thing and the market needs a certain degree of it, as it provides the lubricant that greases the global financial system. There is a necessary trade-off between risk and economic growth, and regulators could potentially go too far and reduce growth at a time when the global economy is still fragile.



Finally, how are industry collaborations in collateral and trading helping to optimise?

Abraham: A quick Google search of the trade headlines over the past months shows a huge amount of activity in this area. At CloudMargin we are continually looking at best-of-breed providers, solutions and technologies that we can leverage or partner with to compliment the service we already provide to our clients, and deliver even more benefits to their businesses.

Earlier in the year we announced our partnership with OpenGamma to embed their post-trade margin replication service within our platform to enhance the cleared derivative workflow by providing our clients early sight of their over-the-counter (OTC) cleared margin call from either their clearing broker or third-party administrator, helping them to provision the requisite funding as early as possible and minimising any associated funding costs.

Adams: The complexities of managing collateral are not specific to individual firms. Challenges cut across the entire industry. Firms are likely to share the same points of failure and, as such, industry collaborations are important. In order to succeed it makes sense to work together to create a cohesive process that takes into account the entire collateral ecosystem.

Industry participants are looking to market vendors to address core functions around pre-trade calculation, inventory management, dispute management, data management, reporting and optimisation.

Fundamentally, they are looking at centralising this across products, taking into account cleared OTC, uncleared OTC, repo, exchange-traded derivatives, exchange-traded derivatives and equity finance. Implementing such a solution may be crucial to keeping an organisation competitive, and this highly complex business requires sophisticated capabilities to be truly effective. Lombard Risk has built and is continuing to develop its collateral management solution based on these principles.

Albanese: There seems to be increased interest in new collateral trading venues—enabling institutions that are long in cash to transact directly with institutions in need of cash. It will be interesting to see how these venues develop, whether they impact demand and supply of collateral, and whether they make the role of a collateral agent even more central than it is today.

Allen: Internally, firms will find that trading desks should provide market prices required to build collateral optimisation and collateral transfer pricing. Credit value adjustment trading desks can provide theoretical collateral costs while other desks provide market prices. Looking at external collaborations, there is a paradoxical situation whereby firms are trying to take a holistic, centralised view of collateral, while isolated pools of collateral activity, such as triparty agents, remain. We see potential for improved transparency and portability in triparty collateral usage.

Lebel: The purpose of industry collaboration is to create utilities and standards allowing for an industrialised treatment of margins. Utilities such as Blazer and MTU foster a higher rate of straight-through processing. Standards like those in the Standard Initial Margin Model are, and will be, used in the computation of the initial margin in the non-cleared space. Making sure all the main factors use the very same mathematical model is a prerequisite; the first step to the industrial treatment of all collateral exchanges should be based on that model. Without such standards, the industry would face a huge increase in the number of disputes, something difficult to handle industrially.

Seagroatt: The collateral ecosystem is becoming more integrated, with triparty agents, custodians and CSDs working together to unlock collateral and mobilise it more easily with lower friction costs. As these entities become more interoperable, this will provide a more efficient global transmission mechanism. It also allows easier identification of idle pools of collateral, which is at the core of optimisation.

Systems providers such as 4sight (now Broadridge) continue to interface with these infrastructure providers to provide value for clients. We are also integrating with offerings by firms such as TriOptima and AcadiaSoft to provide greater automation and straight-through processing around collateral.

Finally, collaboration around blockchain and the use of smart contracts also presents interesting opportunities for efficiency in collateral management. As a result, Broadridge has a strategic investment in blockchain technology in order to ensure we are at the cutting edge of innovation in this area. **SLT**

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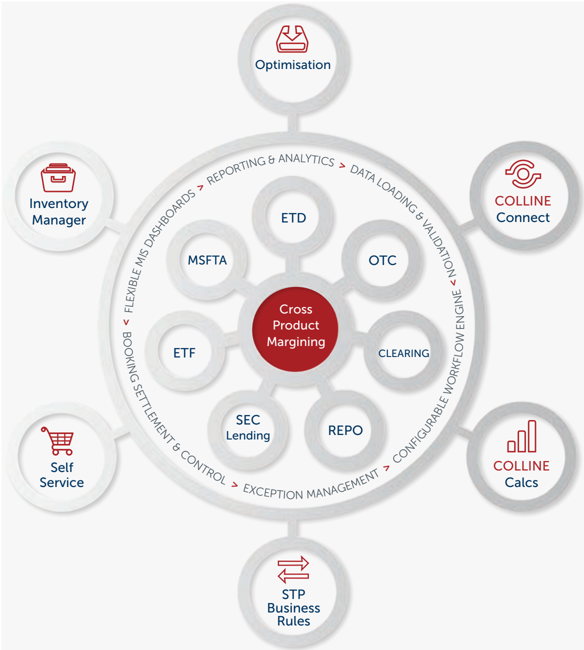

COLLINE: Consolidated end-to-end cross-product (OTC derivatives, repo, securities lending and ETFs) collateral management, clearing, inventory aggregation and optimization.

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For more information:

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Will big data challenge the status quo?

Laura Allen of Trading Apps explains how growing demands for big data analysis from beneficial owners is driving counterparty reporting standards

It's widely reported that 'big data' will change the way we think about business in the years to come. It will explain our current position, plot how we got here, and offer a much-needed insight to the rewards and hurdles that lie ahead. There is a theory that algorithms will replace free thought and decision-making across many industries, and although still in its infancy there is evidence of this within securities lending.

As data processing systems grow in knowledge and power, connecting to them becomes critical for market participants. Lenders have recognised this and are no longer satisfied with the canned reports provided to them by their agents. Lenders have leveraged their position of importance to the agent by gaining direct access to the data providers. There are currently three major data providers covering the securities lending market. Each product is unique in terms of its analytics, frequency of data and number and type of data contributors. Lenders are now demanding bespoke data sets, specific reporting and comparative analysis from these data providers. Many beneficial owners still use multiple agents to lend their assets. This has resulted in a need for much more consolidated reporting whereby the beneficial owner can view performance across multiple lenders within the same portal. Trading Apps can load multiple data feeds from multiple source and aggregate that data versus configurable rule sets and filters.

But, like their agents, lenders want to go one step further. They don't want to rely on the data providers to clean, cut and present the data, they want to absorb the raw data. Accessing the data is one thing but the value of data is what one can gain from all the possible ways it can be employed. Of course, the danger here is that endless data isn't always a good thing. It is now becoming more important than ever for anyone analysing these different data sets to truly understand the underlying constituents and methodologies at play. Having a system like Trading Apps that can aggregate it all and put it in one place is very helpful for the end user.

Data provided to lenders on volumes, collateral, term trading, costs and improved data on income is encouraging the buy side to take control of their lending programs. It comes at little surprise that lenders are no longer satisfied with being part of a pooled program and are striving to move to intrinsic value lending. Securities lending revenue can add additional yield to improve performance against

a fund's specific benchmark, so by using their portfolio efficiently, employing a proactive approach and concentrating resources where they can generate the most revenue, funds can outperform.

Lenders are exploring alternative methods of lending to maximise revenues. Larger funds are exploring the direct lending route initially for the portfolios they lend as 'exclusives' but with an eye on the possibility to transition to a full direct program. Lenders are therefore keen to understand the software solutions available to support direct lending, and over the past 18 months Trading Apps has seen a significant rise in enquiries from this client sector.

Direct lending will create new tasks for lenders that will need to either build or buy software solutions to perform portfolio valuations, manage incoming collateral and measure credit risk, tasks all previously performed by their agent lender. Even with the slow but steady emergence of central counterparties (CCPs) that reduce the barriers to market for lenders, by solving for the collateral management piece and consolidating credit risk to the one counterparty, the CCP itself, the need for system development is real.

Agent lenders recognise this shift and are reacting to their clients needs by acknowledging the requirement for a customised offering. Many are developing a set of a la carte services including operations, collateral management, valuations and indemnification. Clients can then select the services that are important to and compatible with their lending model and pay for them accordingly.

This de-bundling of agency lending services doesn't only favour the lender. De-bundling will allow agents to set hurdle rates, accurately charge clients across different transaction types and optimise revenue for both the lender and themselves. Disparate 'cost of trade' calculations based upon the collateral eligibility schedules across lenders will disable fair distribution algorithms and challenge agent lenders to adjust their models to capture the profitable opportunities and avoid transactions that have capital implications and are likely to prove counterproductive.

For both agents and lenders the need for strong analytical tools is clear, neither sector can function in this changing market environment without the correct systems in place to crunch data. Market participants have expressed an interest or desire to create a universal benchmark to measure lending performance. The obvious issue with this is every lender programme is different and filled with its own intricacies, characteristics and restrictions. We recognised this need at Trading Apps and developed our 'Benchmark App' to solve for it. The platform loads multiple data sources, normalises it and based upon the user's configuration will calculate an indicative fee.

Certainly the market continues to ask for data on a timelier basis. There is currently one provider that offers intraday data in the securities lending space, Trading Apps Benchmark App can load intraday feeds, and as a result those real time data points have become a fixture on our clients securities lending trading desks. We would certainly expect the market to continue to push the other providers for the same level of frequency.

Any lender active in securities financing needs the ability to accurately price, calculate risk, optimise revenue and measure agent/direct-lending performance. This requires data aggregation from multiple sources and advanced reporting and analysis, a space that Trading Apps excels in.

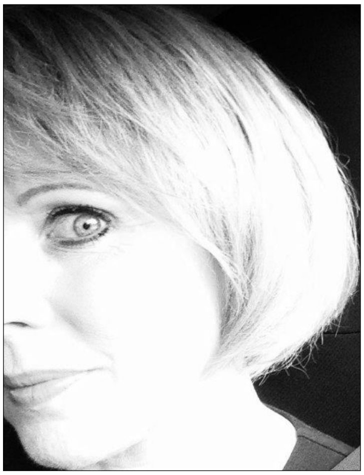
Likewise, agent lenders will need the ability to manage a multi faceted programme. The victors will be those that can analyse data and adapt their programmes to meet the shift in lender requirements offering them the flexibility they require and transparency on the cost of services provided. The introduction of the a la carte service menu will significantly challenge traditional providers' technology stacks. With Glass as our core product, Trading Apps design targeted applications that are quick to build and easy to deploy, helping our clients keep pace with the rapid change we have come to expect in the global finance industry.

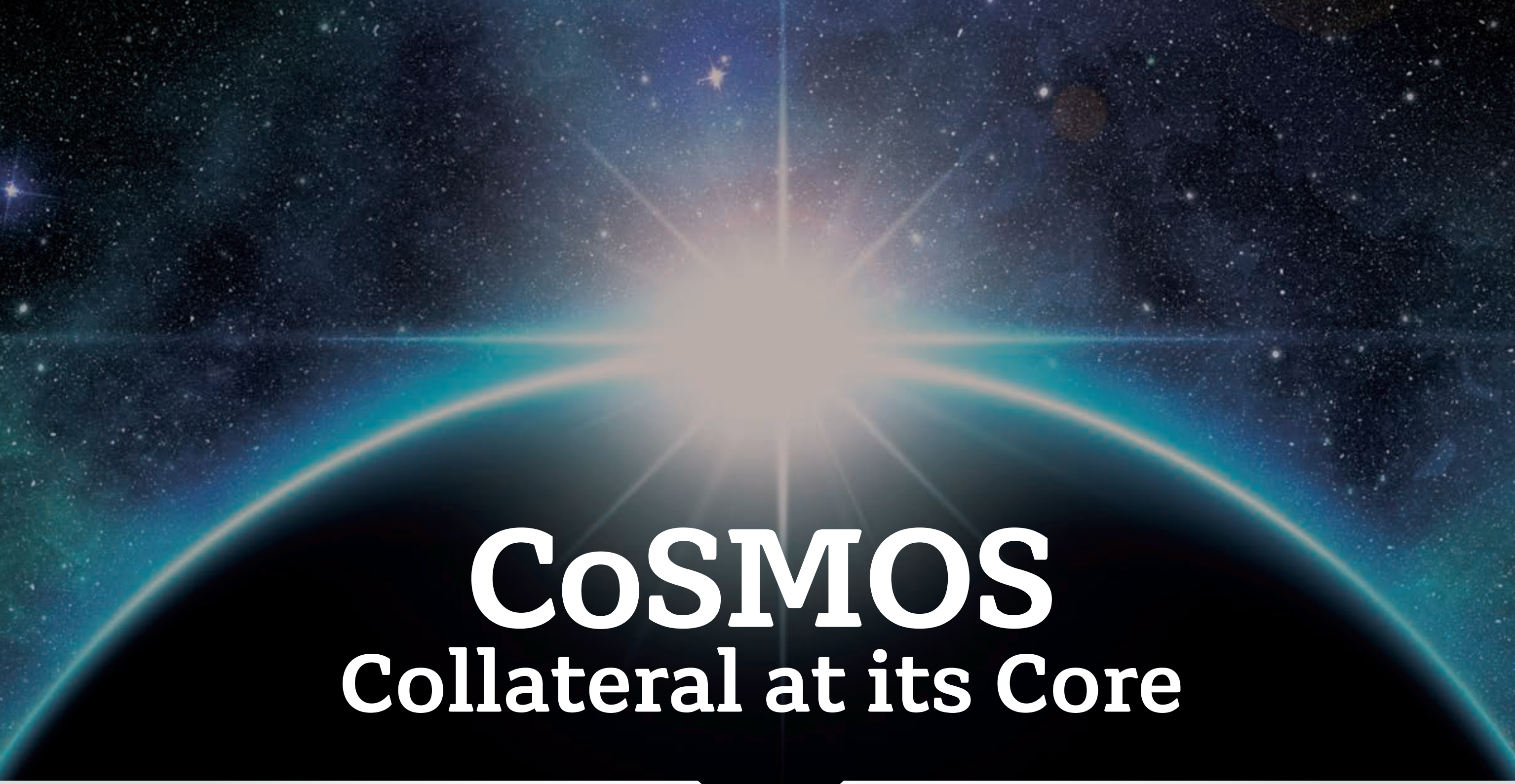
Of course, we need to remember that data is only as good as the person looking at it, otherwise it's just lots of stored information. Not much use to anyone until you add two more ingredients, knowledge of what the data holds and an algorithm to find the patterns and trends within the numbers. Trading Apps recognises this need and each of our apps has an analyser attached allowing the user to manipulate the data according to their specific workflows.

In the future we'll see much more emphasis on data analysis competencies in high-functioning organisations. Big data will become a source of competitive advantage for many firms and the structure of our industry will be reshaped. The rewards however, will accrue unequally and the winners will be found among the firms whose decisions are driven by data. **SLT**

Big data will become a source of competitive advantage for many firms and the structure of securities lending will be reshaped

Laura Allen, Director of sales
Trading Apps





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Transcend Street Solutions

Return to growth

Markus Büttner of Comyno reveals what his company is working on and outlines the most pressing challenges of the moment

As a consultancy firm, what areas are your securities finance clients most concerned about currently?

Without surprise it is the still consistently upcoming regulatory aspects that are in the focus of most of our clients. This proves to be an ongoing task, given that regulation is not yet finalised and is presenting itself as a moving target.

Looking into upcoming regulatory requirements we see a strong interest in supporting the second Markets in Financial Infrastructure Regulation/Directive (MiFIR II/MiFID II) reporting and solving the upcoming reporting requirements. MiFID II transaction reporting and the MiFID II over-the-counter (OTC) trade reporting requirements need to be implemented.

With Comyno being focused on securities finance, the securities finance transaction requirements are also high on our customers' agenda—both from a business process perspective and also solving it technically.

Nevertheless, institutions need to receive returns within this space of regulation and we are helping them to navigate that challenge.

Other than those areas, we currently also see demand, and are actively involved in, optimising the usage of collateral. Of course, this is mostly triggered again by regulation and the subsequent needs and quality requirements. On all sides Comyno is in the strong position to support its clients not only as a consultancy but also as a provider of technical solutions utilising our C-One software platform.

What specific aspects of the SFTR are proving the most difficult? How are you going about solving those issues?

Of all of the Securities Financing Transaction Regulation's (SFTR) requirements, our clients often struggle with the identification of notifiable trades and the identification of reportable transactions occuring in portfolios, along with the decisions on the ideal technical implementation. We help them to decide if they want to roll out specific systems such as Comyno's C-One software platform, which supports all the required messages, or to extend existing infrastructure.

How are you helping your clients to optimise collateral usage?

Collateral optimisation is, even more than our work on strategic topics, a matter of scientific work. The problem to solve, obviously, is to find, categorise and centralise all available assets in an institution that in any way could be given as collateral.

Collateral optimisation techniques are important now and will grow in future as the securities finance market and its regulatory guidelines are still a subject to change. We help institutions to get better returns by automation of the allocation process and minimise the cost of collateral.

The focus is on maximisation of the liquidity capacity of the given inventory and minimisation of the funding costs by identifying the 'optimal' collaterals from the remaining inventory.

We help institutions to handle daily and future exposures in a single optimisation run to cover exposures, meet the given regulatory and bilateral collateral requirements and finding solutions for implementing complex trading agreements and collateral schedules in one system to be more efficient.

Our services here start off with a strategic analysis of the portfolio and the exposures, to identify if there is a possible upside by optimising collateral, and if so, how big it could be. Given a positive business case, we drive the project from the RFP, covering business analysis such as determining cost functions and most efficient workflows, down to the technical implementation and configuration.

Honestly, when we are called into a project that is already in progress but not in a good shape, we often find, in my opinion, over-engineered approaches trying to reach the absolute allocation optimum. In reality, it seems, that with far less effort, institutions would be able to gain the famous 80 percent of the benefits much quicker, but they are lacking the transparency about it not having done the math before.

Has this focus area shifted from last year?

Partially, yes. Interestingly, we are finally working with some of our clients on growth strategies again. We particularly look at how to turn the burden of legislation into new business opportunities. Be it with newly designed products, innovative service offerings or optimisation efforts—that depends on the current setup and possibilities the organisation could provide to the market.

Can you give some examples so we can see where some of these growth opportunities are arising?

When talking about finding opportunities, there are obviously different aspects to the topic: from broadening the landscape of customers and platforms you're trading with, for example, having a look at corporates and their needs. Most market participants should be able to trade with them. If not bilaterally, there is the central counterparty (CCP) route. In both ways, we are helping by 'connecting', and this means of course technically, but sometimes also personally. As a result, customers reduce their credit risk and have additional returns with the ability to source liquidity from others than the usual sources.

Next is triparty business. Look at the setups of your collateral schedules—do they need to be revised to make trading easier or more efficient? Could you be more flexible with your term structures by using evergreen structures both on the repo side as well as the stock loan side?

Everyone knows that certain structures still make money, but not everyone has the processes and infrastructure in place throughout the bank's whole value chain to really support them.

We see growth in the integration of treasury, fixed income, stock loan, proprietary trading and collateral management to be more efficient and to meet the regulatory needs now and in future business. By also supporting CCPs and triparty agents in establishing new products and optimising given processes, we are in the unique position to offer the best possible services for our clients in identifying and establishing new initiatives.

Between your IT and consultancy services, which have you seen more demand for from your clients recently?

Demand in both is strong. As our expertise covers both regulation and growth strategies through automation, customers value the synergies they have by getting excellent business know-how and state-of-the-art software out of one hand.

A desire to increase the volume of automated lending is high on the industry's agenda at the moment. How does Comyno's C-One offering assist with this aim and how does it stand out from the other products out there?

From the very start, C-One was designed to specifically increase straight-through processing in securities finance by serving as a central hub to different trading platforms, CCPs, triparty agents and custodians alike. While other software platforms consider this connectivity to be the customers' problem, to be solved with proprietary interfaces and own IT resources, Comyno considers automation of this ever increasing network of market participants our mission, for the benefit of our industry. 'Fintech made in Germany' is not only a slogan, but a commitment.

C-One has a specific MiFID element to its offering. Will this be extended to assist with the various other regulations that are coming into force over the next few years?

Indeed, our developers focus on broadening the regtech aspect of C-ONE and will be providing solutions for various other regulations. We are currently looking into the technical regulation standards for the upcoming MIFID II reporting and securities finance reporting and are working on an extension of our C-One offering to minimise the burden for our clients in this respect. **SLT**

We are seeing the potential for growth in the integration of treasury, fixed income, stock loan, proprietary trading and collateral management

Markus Büttner, CEO, Comyno

Carpe Diem

Consolo's Sarah Nicholson discusses how the recent launch of the third wave of T2S could present the securities finance market with new opportunities for efficiency that should not be missed

Target2-Securities (T2S) has been a relatively quiet revolution for securities finance. Perhaps seen as an issue wider than just securities finance, it never the less has the potential to significantly change and perhaps even improve the settlement process for the industry.

The third wave of T2S markets transitioned across on the weekend of 12 September, and with it the numerous core securities lending markets. Wave two only included Portugal and Italy but the latest step brought on France, Holland, Belgium and Luxembourg, meaning that a significant part of the European securities finance market is now trading through this settlement engine. The next wave will commence in February 2017 and includes, among others, Germany, which in itself is one of the largest EU markets to go live.

So from a securities finance perspective what does this mean? Firstly the static data for each participant in the migrating markets has to change, with business identifier codes increasing to 11 digits and this in itself has been no mean feat as generally SSIs for the industry are held independently from the firm's main database and each required manual updates, involving operations team manually managing positions and transactions in flight over the transition.

Other aspects of the instruction template have also changed. While the custodians have been very accommodating in managing the process of enriching old-style instructions to meet new requirements, as time goes on client instructions will require amendments and systems will require development to enable this, with many more fields having matching requirements.

However, notwithstanding the potential pain of transition, T2S offers a lot of enriched functionality, some of which seems custom made to reduce risks and improve settlement rates in the lending industry. Functionality such as the ex/cum div indicator could be useful if the market decides to adopt it and may save parties managing the dividend entitlements by amending trade dates, but as a matching field the market consensus is to leave this field blank and continue adjusting trade dates for the time being.

There is functionality that enables you to 'hold and release', whereby you can match trades but put settlement on hold until such time as you wish to release. This could be utilised to more effectively manage bilateral collateral arrangements: matching loans in one market but on hold for settlement until collateral has been received in another. This could be used to manage cross-border cash and security collateral and put an end to potential daylight exposures.

There is also the ability to link trades, so that one settlement can be dependent on another and is seen by many agent lenders as a solution to the bulk delivery process used, whereby an agent transfers a number of shapes into a single omnibus account and then delivers one shape to the borrower. Issues can arise if a number of transactions are pending to ensure that the receipt and onward deliveries match and some agent lenders see the linking functionality as an obvious solution.

However, borrowers are keen to use other functionality such as the ability to partially settle transactions. On a return leg this would allow a borrower to efficiently return any long positions automatically. All it requires is for the lender and the borrower to flag the matching field on the instruction as accepting partial settlements. Of course, from a lender's perspective there is a risk that loans have numerous returns reducing any profitability, but the process has been managed in CREST for years, so agents are familiar with managing the process, and also see the benefit where their client has sold and loan recalls have been required. The automatic partialling could mean that subsequent fails are reduced, and of course, with the Central Securities Depository Regulation coming, this could be important.

The general market consensus is that T2S should be bedded down before the market utilises partialling, but with obvious benefits on both sides it is clear that there will be demand to use this as soon as possible and system vendors are already looking at how this can be incorporated. But here's the rub: if you use linking on a transaction, you can't use partialling. So while one side of the market is building solutions using one function, there may be a growing expectation from the other that a different function will be adopted, and the market can't have it both ways (apparently).

Of course, the European Central Bank, which developed T2S, is keen to see it successfully implemented and utilised to its fullest. It is already listening to the market feedback and working out additional functionality or developments that mean the system is more effective.

This will eventually ensure than even where potential conflicts or issues lie, there may be opportunity to influence the next iteration. As a market, we shouldn't miss this opportunity to ensure we can maximise the efficiencies T2S can offer. **SLT**

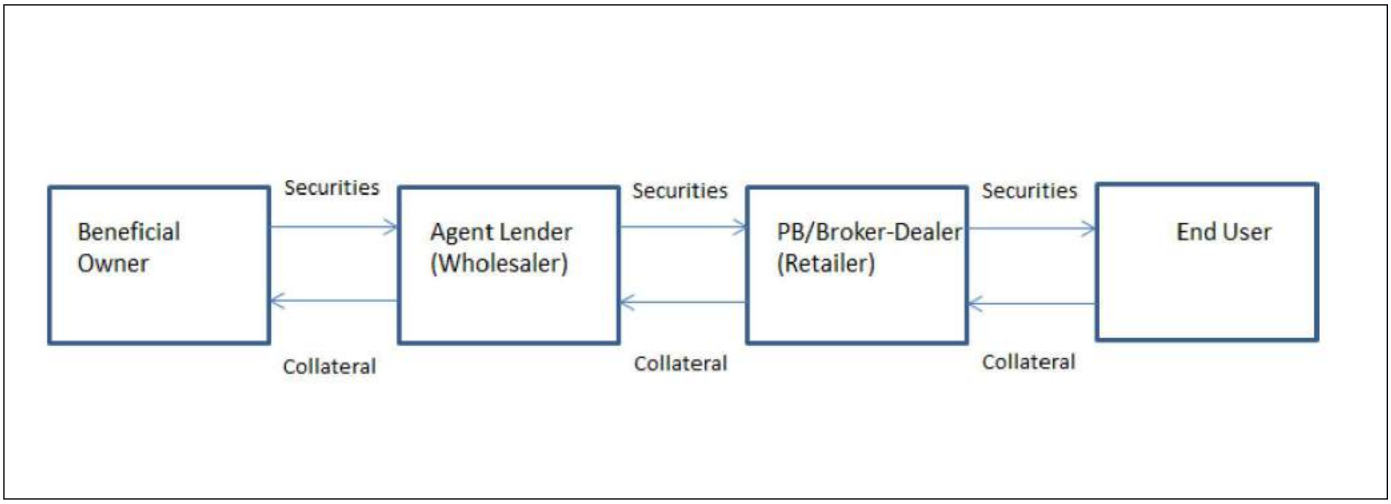
"But here's the rub: if you use linking on a transaction, you can't use partialling"

Sarah Nicholson, Consultant
Consolo

Assessing the terrain

A lot has happened since the 2008 crash and the backlash of regulatory reform is proving to be an equally dramatic force for change in the securities lending market. Glenn Horner of State Street explains

It has been eight years since Lehman Brothers became insolvent and six years since the passage of the Dodd-Frank Act in the US. During this time period many regulations have been implemented, but many more are still being finalised or phased in over time. Thus, while the regulatory environment has already had a significant impact on the securities lending market, the full effects are yet to be realised. One of the easiest ways to understand the potential impact of regulatory changes on the securities lending market is to review the traditional value chain. As costs or bottlenecks increase at any point along the value chain, a shift in the supply and demand curves will occur.



While the above graphic is quite simple, it is also very informative. If we think of agent lenders in the role of wholesalers gathering supply and the role of the borrowers being retailers aggregating demand, then it becomes easier to understand how the regulatory environment has a significant effect on both beneficial owners (suppliers) and end users (consumers).

Pre-financial crisis, the only significant bank regulation that had a constraining effect on the agent lender's role in the securities lending value chain was the risk-based capital (RBC) ratio. When banks acting as agent lenders indemnify clients against borrower default, they must account for the associated risk-weighted assets (RWAs), which impact the overall RBC ratio of the bank. The more capital that must be held to support this RWA the higher the capital costs associated with the securities lending activity.

However, pre-financial crisis, the relative RWA from indemnified securities lending transactions was such that the capital costs were very minor relative to the overall economic value. Under Basel III, especially in the US with the Collins Amendment, which requires the calculation using both an advanced and a standardised method, the potential cost of indemnification may be substantially higher as RWA under the standardised approach may be up to 50 times higher than under Basel I. Additionally, in the US the annual Comprehensive Capital Analysis and Review (CCAR) which is a Federal Reserve-based stress test under adverse and severely adverse scenarios relies on the standardised methodology. Thus, even those banks that are constrained by the advanced, rather than standardised approach, for RBC purposes are ultimately impacted by the standardised method under CCAR. The potential good news is that the Basel Committee has been reviewing the standardised approach and has a new proposal that is still conservative, but will not be 50 times higher than Basel I RWA for securities lending transactions.

The higher RWA under the standardised approach has resulted in restrictions on supply for certain general collateral securities that do not generate substantial reinvestment return through the use of minimum spreads and in certain instances re-negotiations of fee splits.

The second major regulation, from the supply aggregation perspective, is the proposed supervisory framework for measuring and controlling large exposures, or single counterparty credit limits in the US. These limits are aimed at reducing the inter-connectivity of large financial institutions by limiting the exposures that one banking institution can have to any other entity. However, in the US the proposal is to use the existing standardised approach for securities lending transactions. If implemented this would significantly reduce the amount of indemnified transactions bank owned lenders would be able to do with the largest borrowers. As such, the supply of general collateral would be substantially reduced especially for low spread treasuries and sovereign debt securities. For clients with the most conservative reinvestment guidelines, reduced general collateral trades and associated revenues should be expected. For the end user community, this will likely result in further costs for general collateral and potentially an increased need to diversify suppliers of borrowed securities.

Moving down the value chain, the regulatory impacts on the prime brokers and broker dealers has also been substantial. Prior to the financial crisis, there was no global leverage requirement and most of the large US prime brokers were not part of commercial banks regulated by the Federal Reserve or the Office of the Comptroller of the Currency (OCC). Thus, these participants were only constricted by the less onerous Securities and Exchange Commission (SEC) leverage requirements.

However, the major prime brokers have become Fed or OCC regulated since 2008 and are now subject to the more restrictive leverage rules. Since the financial crisis, the Basel Committee has introduced a leverage ratio for globally active banks and the Fed has raised the requirement for US global systemically important banks (G-SIBs). Other jurisdictions have also introduced higher leverage ratio requirements than the minimum 3 percent standard adopted by Basel. Ultimately, nearly all globally active banks, which comprise a vast majority by volume of the borrowers in most agency lending programmes, are now significantly more restricted by leverage ratio concerns. This has led to increased balance sheet management and a greater focus on return on equity rather than return on assets. As a result, non-cash trades and nettable transactions have become more attractive to the borrower community.

Global regulators have become more focused on liquidity measures, as one of the lessons learned from 2008 was that a firm could appear to have sufficient capital but a run on its liquidity could result in insolvency. To address this issue the regulators have introduced the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). The US version of the LCR was finalised in 2014 with a phased-in approach with full compliance required in 2017. Under the LCR, banks must measure potential cash inflows and outflows under a stressed scenario over the following 30 days.

Under the measurement, cash inflows are capped at 75 percent of cash outflows and net cash outflows must be supported by high-quality liquid assets (HQLAs). While a portion of HQLA can be non-sovereign debt with substantial haircuts, the bulk of HQLA will be treasuries and other high-grade sovereign debt. As noted in the previous paragraph, under the leverage ratio constraints the borrowers will be focused on return on equity and the majority of HQLA will be relatively low return on equity securities. As such, borrowers have looked to increase non-cash transactions and term repo on the reinvestment side with extendable or evergreen structures beyond 30 days. Given that the phase in period began in 2015 and full compliance is required in 2017, borrowers have already taken the required steps to meet this requirement.

The net stable funding ratio (NSFR) is still in proposed form in the US and has a proposed effective date of 1 January 2018. Under the NSFR banks must assess required stable funding (RSF) under six months and from six months to one year. The RSF factor for each transaction is based on credit quality, tenor, counterparty type, market characteristics and encumbrance.

Once an RSF factor is calculated, the bank's available stable funding (ASF) factor must be calculated. Regulatory capital and debt beyond one year generally has a 100 percent ASF factor. Other liabilities will be assigned ASF factors based on transaction type, tenor, and counterparty type. The bank will be required to maintain ASF at 100 percent or greater of the RSF.

Of importance is the fact that securities loans and borrowings that are secured by cash and under one year in tenor will have a higher RSF requirement than the ASF of the offsetting trade unless the trades meet certain netting requirements under US generally accepted accounting principles (GAAP) and the supplementary leverage ratio. The difference between the RSF and ASF can be 10 percent to 15 percent, which means that the bank would be required to have excess ASF on its balance sheet or look to fund out over a year.

Despite being in the proposal phase and compliance being more than a year out, some market participants are looking to increase repo funding in evergreen or extendable structures out over six months or a year. Additionally, the NSFR will further heighten the demand for non-cash transactions.

All this does not cover every aspect of how regulatory changes are shaping the securities lending market. Other regulations will have impacts on such items as market and regulatory transparency, potential stays in the event of counterparty defaults and cash reinvestment. However, this summary provides a view into how financial regulations are impacting the supply and demand for securities lending.

Going forward, entities along the value chain will have to increase flexibility and become more innovative in order to maintain or increase their market share of securities lent or borrowed. This includes potentially increasing term and collateral flexibility for lenders, diversifying providers for end users, and developing market solutions such as central counterparties for the industry. **SLT**

Borrowers have looked to increase non-cash transactions and term repo on the reinvestment side with extendable or evergreen structures beyond 30 days

Glenn Horner, Managing director
State Street Bank

Securities lending in 2016 and beyond

Lance Wargo of BNP Paribas takes a look the potential opportunities that the next few years may offer to securities lending participants

The nature of agency lending is changing along with financial markets in the post-global financial crisis era. Agent lenders have become more responsive to their clients, as well as to the needs of their counterparties in the face of complex regulatory requirements. Some institutions view 2016 and beyond as an uncertain time for their securities lending programs, while others have doubled their commitments to the business. At BNP Paribas, we see opportunities on the horizon for our clients and our program, despite unpredictable markets and a heightened regulatory framework

Market dynamics

Asset owners today are confronted with insufficient returns across many capital market activities. The combination of regulation, reduced risk appetite, record low interest rates and lack of program customisation all combine to present a rather challenging future for securities finance. Furthermore, with global interest rates set to remain low, and in some cases negative, for the foreseeable future, investors have to take a fresh look at investment strategies and where value can be extracted on a risk adjusted basis in their securities lending programs. To address the mounting pressure on investment return and principle, asset owners are driven to examine alternative methods and strategies within their investment portfolios to generate intrinsic value and return in areas that may have, up until now, been under-utilised.

Notwithstanding the compelling regulatory and market headwinds investors see today, opportunities to generate securities lending revenue remain robust. Many investors are well positioned to benefit from the variety of different market conditions and trading strategies available in the market today. In particular, opportunities remain abundant as a result of the shift in global growth and commodity demand dynamics, through targeted equity activity focusing on M&A 'specials' and the lending of high-quality liquid assets (HQLAs) across fixed income markets.

In search of yield

The search for incremental returns has led beneficial owners to entertain a variety of revenue generation strategies that fit within their risk parameters. As such, demand for a customised, separately managed account tailored to a client's risk profile continues to gain traction. Many beneficial owners learned a hard lesson during the financial crisis and realised that 'one-size-fits-all' programmes clearly undermine securities lenders' ability to manage risks.

We are experiencing increasing utilisation of tailored securities lending solutions—customisation related to liquidity, reinvestment parameters and asset class expertise are often cited as the rationale for engaging in a third party lending strategy. This is a somewhat different model than 20 years ago and has strong commonalities with portfolio management in that clients tend to take an active approach to program management, including the setting of lending limits and asset class participation. These customised solutions, combined with the transparency they offer, present an effective means for industry participants to capitalise on market opportunities in a risk-controlled manner.

While capital costs remain the primary consideration, the securities lending market has a massive opportunity in the very near future: the rise of US interest rates. This will have a positive impact for beneficial owners, agent lenders, prime brokers and hedge funds alike. The securities lending market has been hampered by an inability to generate revenue from conservative cash investments. Rising rates mean that securities lenders have the opportunity to implement a variety of strategies to reinvest cash and earn a better return than today. At the forefront of these opportunities is engaging in an interest rate mismatch lending and reinvestment strategy. This type of portfolio strategy is very client-specific and not appropriate for all securities lending participants, but is impactful from a revenue generation perspective. While higher interest rates will present some interesting opportunities, it is imperative beneficial owners are comfortable with the adjusted risk return associated with this strategy.

The regulatory environment: headwinds and opportunities

In terms of the amount of regulation that already exists or is due to come into force in the future, it is an unprecedented time for the securities finance markets. At the moment, it may not be possible to accurately judge the extent of these new regulations. Nevertheless, an impact will certainly be felt on demand in the securities lending market. The following key pieces of financial regulation are affecting

tradingapps
Incisive financial tools

the securities lending market today and, are expected to continue to affect the market through 2017.

The global regulatory environment on securities lending has affected both the cost of operating a lending programme while creating capacity issues for many lending agents.

The impact of Dodd-Frank Rule 165(e) on US-domiciled institutions has been strenuous. These institutions are facing capacity issues with many of their counterparties as the 15 percent threshold for many US institutions has been inhibiting the ability to maximise the utilisation rates on specific assets classes or, rather, focus solely on lending securities with the highest spread.

Rule 165(e) is one major piece of regulation affected lending programmes causing lower utilisation rates and thus decreased income as lower margin trades are not conducted. Banks with larger capital bases, such as BNP Paribas, will have an advantage over their smaller peers on this front since they have the capacity to support larger credit exposures and, hence, to accommodate higher business volumes.

The Collins Amendment has made it cost-prohibitive for some US domiciled institutions to provide indemnification against counterparty default. Some US agent lenders are limiting the size of their programs to include only the most profitable clients or implementing minimum spread thresholds to cover their capital costs for purposes of indemnification, while others are adjusting their client fee splits much to the detriment of beneficial owners. At BNP Paribas, we have the flexibility to deploy our capital more efficiently under the advanced approach calculation, which is less stringent than the standardised approach in response to this requirement. That said, we are able to lend all assets classes and lend on behalf of clients without implementing minimum spreads or adjusting our fee split.

Increased regulation on banks and balance sheet usage has had a significant impact on borrower motivation across the industry. The most apparent being the condition on banks to ensure their short term funding requirements, under Basel III (liquidity coverage ratio and net stable funding ratio), are managed in line with regulatory imposed leverage ratios.

The impact of these requirements is a dramatic increase in the demand to borrow HQLA (primarily US and European government bonds) on a term basis, generating significant returns over those achieved on an open basis.

Evolving client demands

Due to regulatory and wider market concerns, participants in securities lending programs require a tremendous amount of continuing education while demanding absolute transparency from their lending program providers. BNP Paribas has openly welcomed this transformation and has made these attributes a pillar of its product offering. We provide clients with a top down and bottom up approach to meet their needs with access to senior management throughout the firm. Additionally, BNP Paribas encourages clients to speak directly with its trading desk to discuss market or regulatory matters.

Despite the numerous headwinds surrounding the securities finance industry, opportunities indeed exist for clients willing to explore a few non-traditional strategies within their lending program.

Collateral transformation and cash collateral remain at the forefront of these opportunities along with direct lending, CCPs, and expanding the permissible borrower base. In addition, the ability to articulate the impact of regulatory changes on the securities lending programme of a client is imperative.

We have been early adopters of the approach that clients are entitled to understand the 'why' and 'how' rather than just the end result. The ability to understand the client and their objectives enables BNP Paribas to design, customise and implement a lending programme suited to each individual client and their goals.

A confident but cautious future

New and enhanced financial regulation has fundamentally changed the securities lending market from one of self-regulation, to one that is centrally regulated through investor guidelines, market directives and direct policy. All participants in securities lending are beneficiaries of these enhanced regulatory policies and directives, and will continue to gain from market transparency and regulatory oversight policies.

Low interest rates and enhanced regulation, however, have greatly reduced certain revenue opportunities previously enjoyed by market participants. But, as new market infrastructure initiatives and enhanced transparency reporting develops—both of which BNP Paribas has been vigorously promoting—securities lenders are well-placed to benefit from the many opportunities that this efficient and highly regulated market can offer. **SLT**

New and enhanced financial regulation has fundamentally changed the securities lending market

Lance Wargo, Head of securities lending, North America
BNP Paribas

Anthony Caserta, Executive director equity finance client strategies, Natixis

Rolling with the punches

Anthony Caserta and Dennis Shikar of Natixis explain how the bank's stable of products can help its clients to navigate the challenges they face in this space

Can you give us an update on the equity finance business at Natixis?

Dennis Shikar: We have an equity finance offering that is exclusively focused on our clients, and nimble enough to meet their needs in a rapidly changing market environment.

Our ability to leverage our regional expertise and create customised solutions that combine our equity financing products has undoubtedly helped us expand our global footprint. Cultivating mutually beneficial, long-standing relationships with our clients is our primary motivation.

As part of our continued business expansion, we recently hired Anthony Caserta to join our client strategies team. Anthony is a 20-year industry veteran, most recently having served as a managing director of equity finance at S3 Partners.

How do you view the equity finance product at Natixis and your role in it?

Anthony Caserta: Our offering, which combines multiple products to provide global market access, allows us to structure creative, customised equity financing solutions that are beneficial to our broad client base in this increasingly dynamic market environment.

My focus will be on increasing the Natixis brand profile, especially in the US. We are optimally positioned to provide financing solutions to a wide range of clients, including asset managers, insurance companies, hedge funds, pension plans, mutual funds, corporates, banks and dealers. It is very exciting for me to be able to combine my sell-side and buy-side equity finance experience to help expand our offering and our client base.

What are the advantages of your product structure?

Shikar: Traditionally, securities lending, forward trading and collateral trading were separated into different product groups. As expected, regulatory changes have created challenges for each. The fact that we have been able to combine these services on a global basis has certainly helped us structure wrappers to meet our clients' needs, regardless of the region or underlying currency.

Natixis Synthetic Services is a good illustration of our solution-based capabilities. It is our synthetic prime product, which bundles synthetic exposure, market access, leverage and financing as an integrated solution to substitute physical investments in a portfolio. Natixis is a highly rated, alternative source of financing and diversification of credit risk. Through this structure our clients have access to our global supply of equities, including stable inventories of small and mid-cap securities. While the fundamental needs of our clients have not changed, the

method by which we can satisfy those needs has. The current regulatory environment has placed a premium on creativity and the ability to adapt and act quickly. In this respect, we are extremely well positioned to continue to grow.

There has been a lot of change in equity finance in recent years. Do you see this continuing?

Shikar: We will undoubtedly see this trend not only continue, but do so at an increasing rate. To say the equity finance market has changed over the last ten years is an understatement. There have been material shifts in the landscape that have forced all market participants to adapt. The securities lending product is an excellent example of this. While the fundamental function of facilitating short selling still exists, the market structure and other benefits that the product offers are very different. Market transparency and the push towards central counterparties (CCPs) have never been greater. Securities lending structures are a valuable tool in solving ever-changing client requests.

Caserta: Vastly improved technology, increased transparency and regulatory initiatives have all contributed to the evolution of the equity finance business. However, it would be fair to say that new regulations and collateral requirements have taken the forefront. Consider the effect of these new requirements on the traditional relationship between hedge funds and prime brokers.

Along with balance sheet constraints, the regulatory overhaul has resulted in limited capacity for prime brokers and higher costs for hedge funds. Without question, Natixis' unique structure and position in the market allows us to partner with both buy-side and sell-side clients to help them overcome these new challenges.

What are some other examples of how the new regulatory initiatives are affecting the equity finance market?

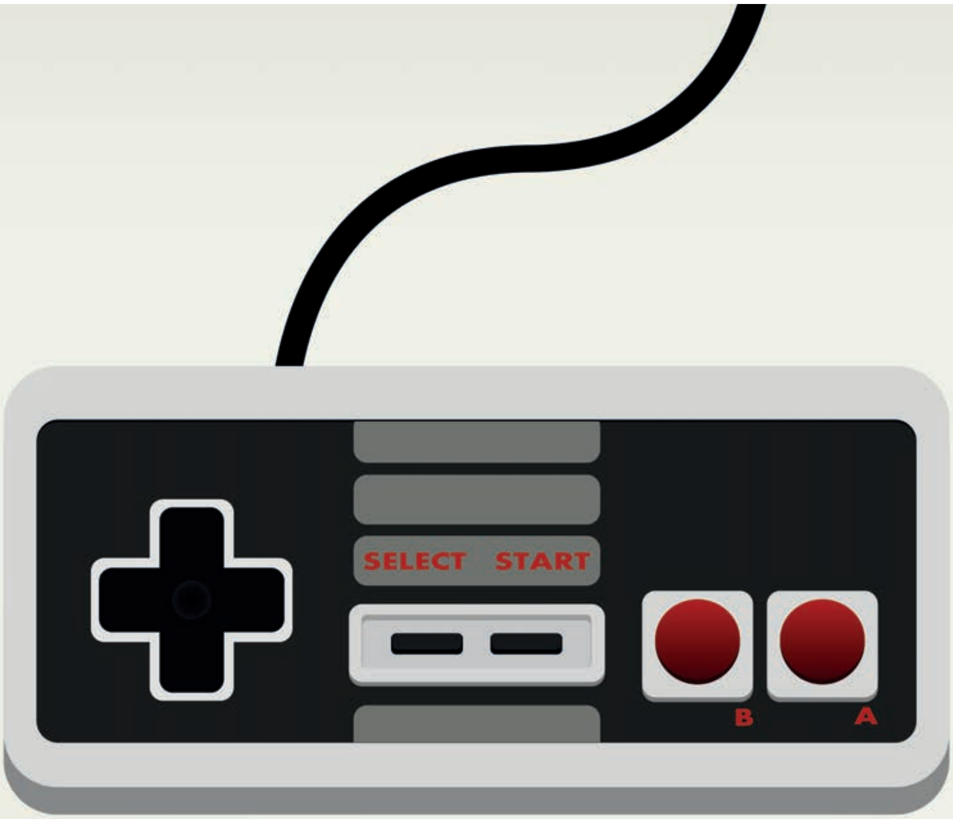
Shikar: Balance sheet optimisation continues to become increasingly important. While the move toward non-cash transactions to limit balance sheet consumption and provide liquidity coverage ratio relief has existed for some time now, we are seeing a shift away from short term funding and toward longer term structures. There is a greater focus on cross asset collateral upgrade transactions as the demand for high quality collateral expands. Additionally, clients are looking more and more for synthetic solutions to their long and short financing needs.

It seems that not only will these trends dominate as we move forward, new ones will certainly emerge. We take great pride in our ability to address the current challenges and structure solutions that anticipate those to come.

What role will Natixis play in the equity finance landscape going forward?

Caserta: The ongoing changes in the regulatory environment will continue to create hurdles for all market participants. Natixis is in a great position to meet the ever changing needs of its clients. Our ability to structure innovative solutions through multiple equity financing products for clients in all segments of the financial markets is exciting. The equity financing landscape continues to evolve and present new challenges for everyone. However, along with these challenges will come new opportunities as well. We will continue to partner with and provide our clients with unique and customised solutions. **SLT**

Dennis Shikar, Managing director, head of equity finance Americas
global head, equity finance client strategies group, Natixis



Impetus for change

The rules of the game have changed. Industry participants need to adapt to survive. Stonewain's Armeet Sandhu explains

The securities finance landscape has changed quite dramatically over the years. The impetus behind these changes can be attributed to various factors, including regulatory requirements, revenue compression, and industry innovation.

Due to the larger macro impact of regulation, our industry is forced to do more with less, which in turn has had an impact on all aspects of securities finance. Restricted budgeting models have had an obvious effect on staffing strategies and requirements. Industry is forced to come up with creative solutions to to accommodate these changes in an increasingly complex operating environment.

Manifestation of change

This continually evolving and challenging environment has elicited a shift in the manner in which businesses operate. Institutions are required to adopt a much more strategic approach to their business activity by modifying their trading strategies, selectively targeting new clients, and optimising institutional balance sheet usage to support existing clients.

Some firms have invested well in optimising their resource utilisation. Such firms are at the head of the industry in this regard, utilising an optimal client mix to fit with firm's strategies and deploying internal processes that maximise return on balance sheet usage in a holistic manner. We are also seeing new entrants in the space created by compression of services historically provided by the leaders. There continues to be discussions and movements towards the opening of new routes to market such as peer-to-peer lending or non-indemnified lending by beneficial owners.

Innovations in the industry are also bringing forth significant changes to the securities finance landscape, such as through the perpetual evolution of automated lending and borrowing. This has evolved from basic transaction initiation to complex rules-based engines for not only the borrowing and lending of securities, but also for straight-through processing and/or trade settlement. The evolution of central counterparties (CCPs) is another area of innovation and the development of efficient CCPs provides opportunities for all participants.

Transformational technology

The widespread strategic modifications driven by the changing securities finance landscape has increased the importance and value of robust and flexible technology. Technology is instrumental in providing visibility and analytical tools to determine which clients and trading strategies are most profitable. Technology is also crucial to gaining efficiencies in communication with other vendors, industry utilities such as CCPs and pre/post-trade services, and other firms. Additionally, a current and well-built technology platform enables effective resource allocation to focus on exception based issues and problem solving, rather than routine tasks.

Securities finance technology

The current terrain of securities finance technology is comprised of quite a few long-established services. Overall, the industry utilities like EquiLend and Pirum are reacting to industry needs by providing new and enhanced services.

However, there is a drop-off in the pace of change in technology utilised by the industry to interact with the utilities. This mismatch prevents the full realisation of the potential benefits from both industry and technology innovation.

Institutions with significant internal technology face the traditional dilemma of investing in internal development (whether module-based development to existing platforms or completely brand new development). This investment has significant associated costs, or solutioning through IT providers. Firms with deep pockets and large internal IT staff can afford in-house development to gain an advantage by keeping pace or leading the innovation.

On the other hand, there are firms that do not have resources available and are required to look for vendor-provided solutions. However, if the vendors are unwilling or unable to provide comparable technology then at what point does this become a problem for the overall securities finance arena? Inevitably, there should be a balance between the two that will allow for a healthy securities finance topography.

Access to technology solutions

The goal is to provide access to required and needed technology across the spectrum to current and new participants. The benefits will be high quality trading partners with robust capabilities, lowering of overall industry spend on tech while preserving resources to focus on innovating. The realisation of these goals will attract new market participants, create participant diversity, and enable response to regulatory needs, such as single counter party limits or the Securities Financing Transaction Regulation.

Stonewain's Spire platform provides a robust, capable and affordable platform to the industry; ensuring wide access to a exceptional technology solution for all participants in the industry. We feel that cutting edge solutions like Spire in conjunction with the services from the utility vendors, will create a better business and operating environment for the entire industry. Otherwise the mismatch of capabilities of various participants will create a drag on industry growth and innovation.

We see that the time for change is here. Old and antiquated solutions can no longer be patched and hacked to support constantly evolving needs. The pace and scope of change is too large and the ability to create robust and fail-proof solutions using old systems is no longer possible. The older solutions were created in a much simpler business environment and were able to evolve and keep up during periods of slow change. Now, we operate—and will continue to operate for the foreseeable future—in a dynamic and rapidly changing environment. There is a strong need for solutions that are agile and developed to be nimble and open. Change is the only constant—you need your technology solutions to do the same.

At Stonewain we have addressed this challenge by creating Spire, a modern, complete, easy-to-use solution that is constantly evolving to address industry needs. Spire provides out of box integrations with industry utilities, software-as-a-service and turnkey operations. The solution includes pricing algorithms and optimisation engines to enable automation of trading decisions, execution and maintenance. Accounting engine, analytics and reporting enable opportunity discovery and true macro/micro profitability views. All of this is supported by a true straight-through processing engine that empowers users to focus on exceptions and architecting complex solutions. Key data elements are captured, preserved and accessible easily enabling true transparency for internal oversight, clients and regulators. **SLT**

There should be a balance that will allow for a healthy securities finance topography

Armeet Sandhu, CEO
Stonewain Systems

Great challenges, greater opportunities

Regulatory change remains a driving force behind many of the new opportunities and challenges facing the securities finance industry. James Slater, global head of securities finance at BNY Mellon Markets, discusses the causes and effects, and how market participants are adjusting their behaviour to adapt to this new paradigm

Market participants and global regulators acknowledge the critical role that repo agreements and other securities finance activities play in the efficient functioning of capital markets.

The financial crisis exposed real weaknesses, especially where providers of liquidity fundamentally lost confidence in dealers and banks resulting in the near collapse of the wholesale funding markets. The crisis brought to light unique risks from the excessive use of short-term wholesale funding and repo agreements in particular. Furthermore, maturity mismatch in wholesale funding and the nature of the triparty repo settlement mechanism highlighted further systemic issues that needed to be addressed. These created a situation only made worse by the tendency of money market funds to regard the repo market as equivalent to a bank deposit from a risk perspective, creating additional systemic issues and prompting government intervention.

The resulting loss in funding liquidity led to significant instability across the broadest range of securities finance structures contributing to market volatility as borrowers of all types and sizes adjusted to increased margin requirements, increased costs, recalled loans and in extreme cases, the total loss of funding availability. Looking back, it is easy to see how certain behaviours and market practices necessitated government intervention with wholesale funding and collateral management reforms becoming a cornerstone of global regulators' post-crisis efforts to reduce risk in the financial system.

High-quality collateral

The new regulations, particularly the Basel Committee on Banking Supervision's leverage and liquidity coverage ratios, have significantly altered the business models of all the world's largest financial intermediaries. While the leverage ratio significantly discourages the use of cash as collateral, the liquidity coverage ratio rewards the control of high-quality collateral, or as referred to under many of the new regulations, high-quality liquid assets (HQLAs). The defining criteria for HQLA eligibility is that it should be relatively easy to monetise via sale or funding transactions even during periods of significant market instability. Broadly speaking, the effect of the new regulations is that financial institutions can no longer intermediate as they once did, despite increasing demands from buy-side market participants for additional liquidity. Naturally, this has caused dealers and banks to pursue ever more creative ways to achieve optimal balance sheet and collateral management efficiencies in order optimise returns for their investors.

There are several consequences from a securities lending perspective. There is more focus on the pledging of securities as collateral due to its superior balance sheet efficiency relative to cash. This is a big change from the pre-crisis environment, especially in the US market where cash, unlike in Canada and Europe, has always been the predominant form of collateral. For lenders able and willing to take non-cash collateral this has the potential to lead to increased fees, but to be fair this may not offset the loss of increased returns realised through more aggressive reinvestment programmes. At the same time, some beneficial owners are also benefiting from a brand new source of borrowing demand resulting from the market's need for HQLA to manage liquidity coverage ratio or other collateral requirements. Referred to as collateral upgrade trades, lenders are benefiting from an increased demand for high quality collateral and borrowers are willing to pay reasonable premiums for term commitments when they are available.

CCPs and bilateral collateral

As we look forward into 2017 and beyond, we believe that banks and dealers will continue to be more constrained in their ability to further intermediate in the market, which will increase the need to optimise their activities in every way possible. Another potential avenue being discussed in the context of balance sheet efficiencies is the increased use of central counterparties (CCPs), which will allow market participants to more efficiently net offsetting cash transactions as well as achieve material risk weighted assets (RWAs)-related capital efficiencies. The dealer community and certain banks are looking at CCPs as a way to continue to keep scale in their business. Beneficially, CCPs are generally willing to accept high-end HQLAs such as treasury securities, further increasing demand for high-quality collateral.

New and evolving margin rules for both cleared and uncleared derivatives transactions (including non-deliverable forwards (NDFs), FX forwards and FX swaps) are also creating increased HQLA collateral demand. Going forward, generally all market participants can expect to have to post both initial and variation margin requiring many buy-side clients to consider issues that they've previously never had to address. These include simpler tasks such as managing the collateral provision and recall process, but also potentially something materially more involved and risky such as transforming non-conforming assets into eligible collateral.

Anticipated changes in collateral acceptability and the borrower's and collateral manager's desire to optimise any collateral they have on hand, whether that be cash or securities, underscores the need for flexibility to address the constantly changing needs for the full range of jurisdictions and transaction types. In addition, this is a global initiative, one that may require either a significant investment in technology and human capital or the securing of a third party's collateral management services.

The collective regulatory changes and the market's response have resulted in a range of interconnected inefficiencies. The leverage ratio has driven banks to be reluctant to accept cash deposits and has steadily driven investors back to money market funds offsetting the reductions realised during the crisis. That trend, however, is expected to reverse once again with the money market fund reforms coming this fall. In fact, it has been estimated that as much as several hundred billion dollars will relocate from prime money market funds, many previously providing repo finance for a broad range of asset classes, into treasury funds. This is going to put more pressure on the wholesale funding markets and the demand for HQLAs, which will create a new environment for the market to contend with. In short, collateral is the new cash. Or, as we like to say, collateral is king.

Due to new collateral requirements and reduced capacity of many intermediaries, we believe the buy side needs a range of solutions to more efficiently mobilise their assets. For example, traditional multi-manager structures create difficulties in accessing securities in one portfolio that could be used as collateral or to support leverage strategies in other portfolios.

Taken in aggregate, these are big changes for the marketplace. Collateral flexibility and liquidity solutions have never been more important. We see an opportunity to create new services and capabilities for our buy-side clientele. At BNY Mellon, we are working with clients to develop solutions to help them unlock the full value of their assets, raise liquidity and to provide and manage needed collateral when required. We continue to invest around innovative solutions, automation and technologies that help us understand and service our clients better. **SLT**

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> ***The collective regulatory changes and the market's response have resulted in a range of interconnected inefficiencies***

DATALEND • USA

-------------------- ALL FIGURES ARE FROM DATALEND'S USA DATA AND ARE AVERAGES FROM JANUARY 1 TO JULY 31, 2016 --------------------

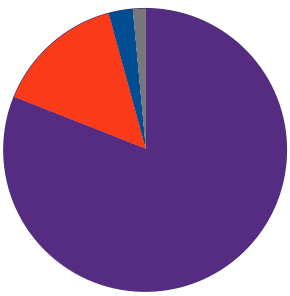
LENDABLE	ON LOAN	YTD REVENUE
$7.71 TRILLION	$1.01 TRILLION	$2.52 BILLION

MOST PROFITABLE SECURITIES

SECURITY	REVENUE	SECURITY	REVENUE
1. TESLA MOTORS	$190,280,507	6. MANNKIND	$26,417,556
2. SOLARCITY	$94,018,904	7. INSYS THERAPEUTICS	$24,500,929
3. CAL MAINE FOODS	$80,350,068	8. WAYFAIR CL A	$21,215,430
4. CHESAPEAKE ENERGY	$31,843,199	9. WEIGHT WATCHERS	$21,099,908
5. CHARTER COMMUNICATIONS	$30,209,783	10. CREDIT ACCEPTANCE	$20,764,442

AVERAGE ON LOAN BY ASSET CLASS

FIXED INCOME



SOVEREIGN DEBT 81%

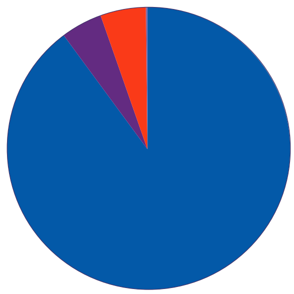
CORPORATE 15%

AGENCY 3%

OTHER 1%

TOTAL ON LOAN: $459.59 BILLION

EQUITIES



COMMON SHARES 90%

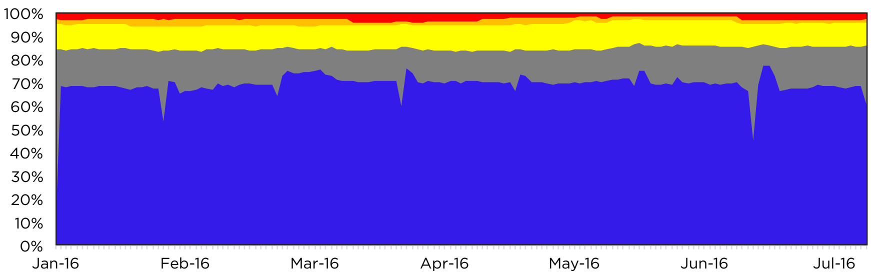
DEPOSITORY RECEIPTS 6%

ETF/ETN 4%

OTHER 0%

TOTAL ON LOAN: $552.79 BILLION

EQUITY HEAT MAP (AVERAGE FEE)



Fee > 500bps

250bps < Fee < 500bps

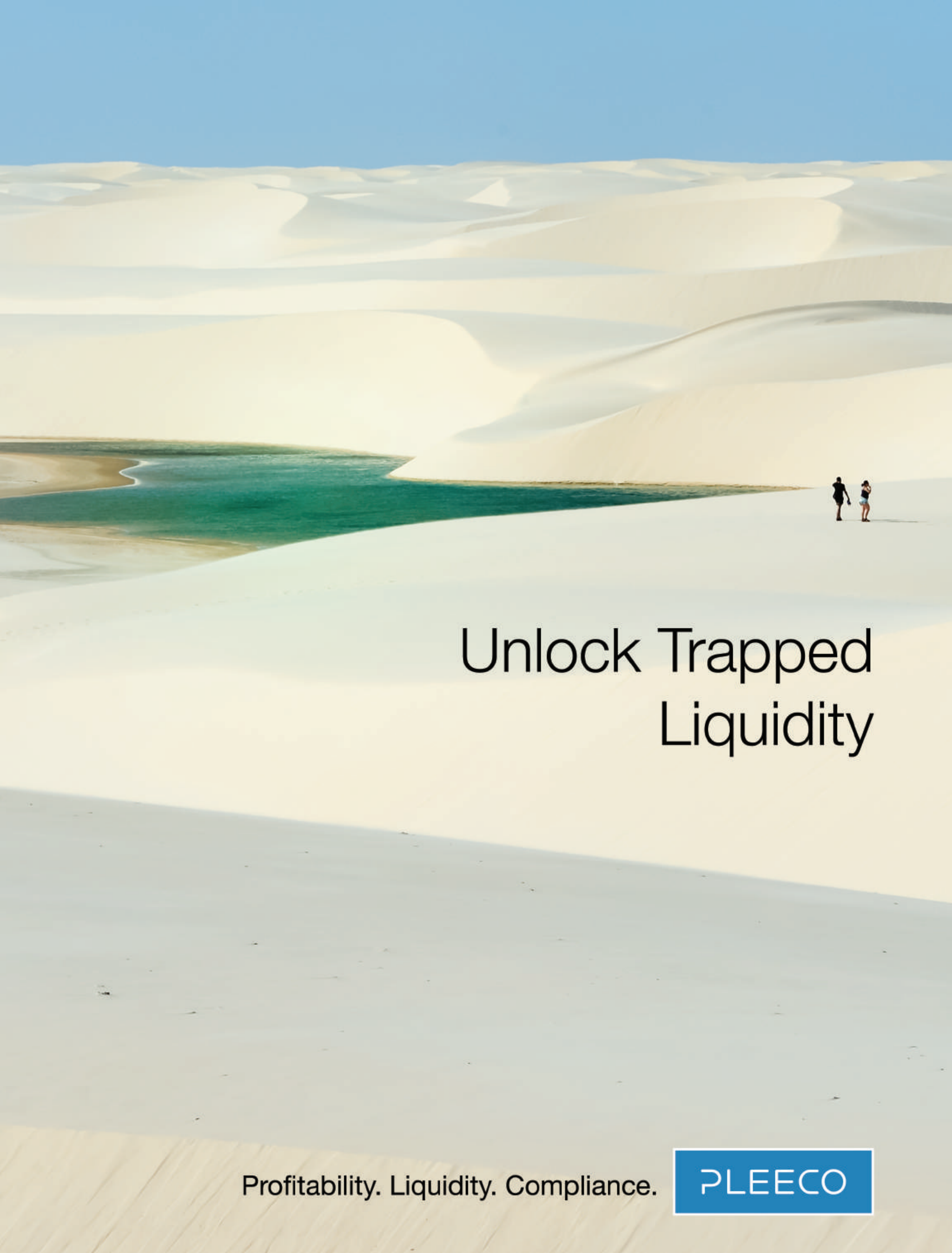
50bps < Fee < 250bps

20bps < Fee < 50bps

Fee < 20bps

TOP 5 HOTTEST SECTORS BY FEE

	Sector	Fee	Hottest Industry
1	ENERGY	90bps	COAL AND CONSUMABLE FUELS
2	CONSUMER STAPLES	89bps	HOUSEHOLD AND PERSONAL PRODUCTS
3	HEALTH CARE	85bps	BIOTECHNOLOGY
4	CONSUMER DISCRETIONARY	84bps	AUTOMOBILES & COMPONENTS
5	TELECOMMS	74bps	ALTERNATIVE CARRIERS


Unlock Trapped
Liquidity
Profitability. Liquidity. Compliance.
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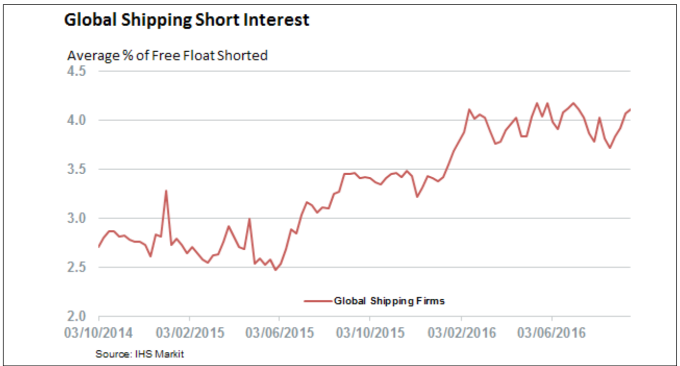
High seas short sellers prefer energy shipping

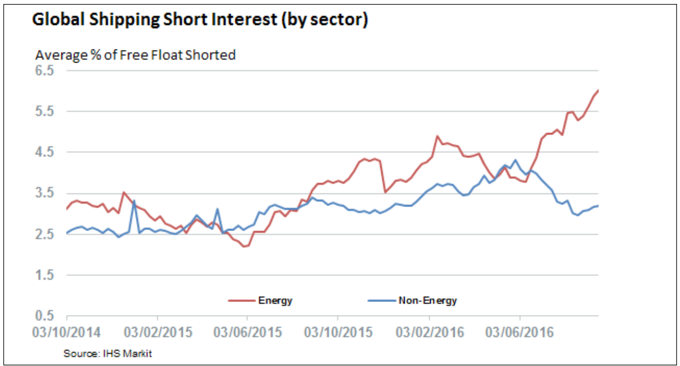
Short selling in global shipping firms stands at a multi-year high as the industry reels from oversupply, which has depressed charter rates and sent several heading to cover from creditors. IHS Markit's Simon Colvin reports

The shipping industry's ongoing slump claimed its largest scalp recently as South Korean container ship operator Hanjin Shipping, the ninth largest container operator, declared bankruptcy. This followed a stream of bankruptcies among dry bulk and oil shippers since the start of the year, as all corners of the industry reel from slowing global trade and a chronic oversupply of ships ordered under rosier market circumstances.

Short sellers, which have never shied away from marine shipping, have continued their activity within the sector with the average short interest across the 85 shipping firms holding a market cap that now stands at the highest level in over two years, according to IHS Markit Securities Finance.



The current average demand to borrow shares in shipping firms now stands at 4.12 percent of free float, which is more than 20 percent higher than at the start of the year. This bearish sentiment has paid off so far, as the 85 publically listed marine shipping firms have fallen by 15 percent on average since the start of the year. However, this continued appetite to sell short indicated that these sellers are preparing for a further patch of rough weather ahead.



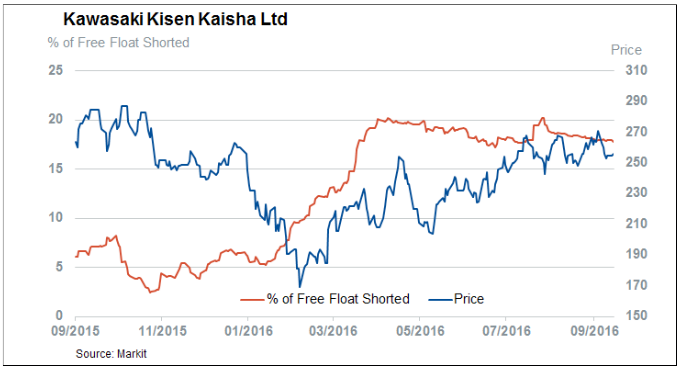
While the average short interest in marine shipping firms has stayed relatively flat in the last few months, we've noticed that short sellers have been rotating out of non-energy related shippers into the energy space.

Demand to short energy-related shipping firms, which includes tanker and LNG owners and operators, now stands at over 6 percent of free float on average for the first time since the current downturn in energy prices. The demand for floating storage had isolated energy shippers from the worst of the shipping downturn, but spot charter rates are now tracking materially lower than last year due to an influx of new supply and a shift in global routes. Operators favored by short sellers include Ship Finance International, Dorian and DHT Holdings, all of which have seen short interest more than double year-to-date—passing the 15 percent of free float mark.

Name	Ticker	Sector	% of Free Float Shorted	Ytd % Change
Ship Finance International Ltd	SFL	Energy	20.8	**97%**
Nordic American Tanker Ltd	NAT	Energy	19.3	**19%**
Kawasaki Kisen Kaisha Ltd	9107	Non-Energy	18.0	**178%**
Gaslog Ltd	GLOG	Energy	17.2	**-22%**
Dorian Lpg Ltd	LPG	Energy	16.4	**128%**
Dht Holdings Inc	DHT	Energy	15.8	**671%**
Scorpio Tankers Inc	STNG	Energy	13.4	**277%**
Kirby Corp	KEX	Non-Energy	12.4	**918%**
Teekay Corp	TK	Energy	12.0	**132%**
Hanjin Shipping Co Ltd	117930	Non-Energy	11.2	**187%**
Ardmore Shipping Corp	ASC	Energy	11.0	**3153%**
China Cosco Holdings Co Ltd	1919	Non-Energy	9.2	**-4%**
Mitsui Osk Lines Ltd	9104	Non-Energy	9.1	**-36%**
Frontline Ltd	FRO	Energy	9.1	**975%**
Dampskibsselskabet Norden A/S	DNORD	Non-Energy	7.9	**17%**
Bw Lpg Ltd	BWLP(	Energy	7.9	**54%**
Scorpio Bulkers Inc	SALT	Non-Energy	5.3	**-24%**
China Shipping Container Lines Co L	2866	Non-Energy	6.1	**-6%**
Korea Line Corp	005880	Non-Energy	5.4	**127%**
Seaspan Corp	SSW	Non-Energy	5.1	**42%**

Despite the recent Hanjin bankruptcy, short sellers are largely avoiding the non-energy related part of the shipping sector as their current average short interest stands at the same level seen in January. These diverging paths mean that the gap between the average short interest seen on both sides of the market is at its widest in over two years.

As ever, there are exceptions to the rule as Japanese shipper Kawasaki Kisen Kaisha has seen its short interest nearly triple since the start of the year. This makes it the most shorted non-energy focused shipping firm with 18 percent of its free float out on loan.



Short sellers have been equally voracious in targeting US barge operator Kirby Corp, whose short interest has jumped by more than 900 percent year-to-date to more than 12.4 percent of its freely traded shares. **SLT**

Industry Events

33rd Annual RMA Conference on Securities Lending

Date: **10-13 October 2016**
Location: Boca Raton, Florida

The original industry-wide conference sponsored and developed by securities lending and borrowing professionals for securities lending and borrowing professionals. This conference brings together all the players involved in the business of securities lending. It is designed by securities lending and borrowing professionals for individuals from banks, brokerage houses, pension funds, endowments, and regulatory agencies in both the US and Europe. Topics include collateral management, international market updates, performance measurement, and legal and regulatory updates.

10th Annual Collateral Management Forum

Date: **20-21 October 2016**
Location: Amsterdam

The tenth 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

Arrivals and departures at OCC, Trading Apps and EquiLend

Options Clearing Corporation's (OCC) Craig Donohue has agreed to stay on as executive chair and CEO for three additional years after his term expires in December.

The extended term will also see an extensive re-shuffle of OCC's senior leadership and the creation of an 'office of the executive chair and CEO'.

Along with Donohue, the new governance structure will include Michael McClain as COO and Scot Warren, formerly executive vice president ofbusiness development, in the more senior role of chief administrative officer.

"As chief administrative officer, Scot Warren will be responsible for driving enterprise alignment and enhanced execution of our corporate objectives, which includes creating a high-performance execution environment and improving the enterprise-wide culture of ownership and accountability," said Donohue.

"This is the right leadership structure for OCC's needs today, as it allows us to combine the breadth and depth of experience necessary to optimally support the organisation as we move forward," he added.

OCC is also bringing in fresh faces to a number of other senior roles.

John Fennell, formerly executive vice president of financial risk management, is taking on the role of executive vice president and chief risk officer, following the departure of John Grace.

Fennell will be responsible for implementing OCC's risk management strategy and will oversee OCC's model validation and enterprise risk management departments, along with security services, business continuity and disaster recovery, and vendor risk management areas.

His previous position will be filled by Dale Michaels, who joined OCC in January to work on the clearinghouse's securities lending initiatives.

Additionally, Julie Bauer joined OCC as senior vice president for government relations. She will be responsible for developing and managing OCC's legislative, regulatory and educational activities with members of Congress, regulators, and other policy makers, along with representatives of the exchange and financial services sectors.

Trading Apps has bolstered its senior leadership with the appointment of Ian Cox as COO.

Cox is based in London and reports directly to Trading Apps CEO Matthew Harrison.

Prior to joining Trading Apps, Cox served most recently as regional director for the buy side at Fidessa, a London-based financial software provider, where he has worked in various roles since 1997.

At the same time, EquiLend's Chris Valentino has also joined Trading Apps as sales manager for North America.

Valentino, who comes to Trading Apps fresh from a four-year tenure as head of US sales at EquiLend, will continue to be based in New York and report to Cox.

EquiLend has brought on Ken DeGiglio in the newly created role of chief information officer (CIO) and as a member of its executive team.

As CIO, DeGiglio will manage a senior team of IT professionals and work closely with product owners and other internal stakeholders.

DeGiglio, who will be based in New York, joins from TD Ameritrade, where he was most recently managing director and head of application development. His CV also includes stints at Morgan Stanley and J.P. Morgan, along with founding Renaissance Trading Technologies (now NYFIX).

Brian Lamb, CEO of EquiLend, said: "Ken DeGiglio's robust technical knowledge and experience in financial systems made him a clear choice to serve as EquiLend's CIO."

"He will be a great asset to EquiLend and to our client base as we continue to bring innovative new technologies to the securities finance market." **SLT**

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