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A banner year for lending

Political upheaval, energy sector disruption and a crop of consistently high-earning shorting targets helped to make 2016 a "banner year" for securities lending, according to Simon Colvin of IHS Makit.

Lending revenue was expected to beat last year's total by 6.3 percent, making it highest revenue generating 12 months in more than five years.

Last year saw revenues of $8.06 billion, as of 20 December, compared to the $7.81 billion earned in 2015.

The Markit Securities Finance database monitors more than $15 trillion of assets in lending programmes.

According to Colvin, the bumper revenue haul was mostly driven by lenders achieving better pricing as the weighted average fees, year-to-date, hit 43.8 basis points (bps)—1.1 bps higher than 2015.

The importance of this price boost is highlighted by the fact that demand was flat over the year, as the average balance was recorded at $1.45 trillion, or the same as 2015.

By region, IHS Markit's data revealed that the strong revenue haul was not been spread equally across global markets.

North America, which took the lion's share of global lending revenue, Asia and the Nordics all saw 2016's revenue build on 2015, while Europe slumped, primarily due to the unwinding of the German yield enhancement trade wiping as much as 62 percent off German equity revenues.

North American equities, led by the US, have accounted for 40 percent of global securities lending revenue in 2016 and appeared to beat their own 2015 performance by 8 percent, due to a 9 percent uptick in loan balances.

Colvin highlighted that "unsurprisingly, energy producers were at the forefront of this wave of shorting activity as demand to borrow their shares was three times higher than the rest of the index".

"Despite the recent rebound in oil prices, the sector is still responsible for a fifth of the North American shares trading special as many producers continue to face headwinds, with oil trading in the $50 to $55 range."

Turning to specific high-interest stocks, US electric car manufacturer Tesla provided an "outsized contribution the the industry's revenues", with demand to borrow never falling below 15 percent of shares outstanding, according to IHS Markit.

In Europe, revenue lagged by 7 percent, representing a $115 million shortfall.

For securities lending participants, the pain caused by the German market upheaval was mitigated somewhat by the UK's unexpected vote to leave the EU, which contributed to UK-specific revenue outdoing 2015's figure by 27 percent, valued at $35 million.

Colvin explained: "Uncertainty surrounding Brexit has been the main catalyst driving the increased UK revenues as short selling in UK equities has surged to a multi-year high since the referendum vote back in June."

This trend is likely to continue in 2017 as average demand to borrow constituents of the FTSE 350 sat at at 2.3 percent of shares outstanding, the highest in over two years, according to IHS Markit data.

Meanwhile, Asia's lending revenue trajectory suggests it will soar over 2015's regional figure by 11 percent, thanks to fees to borrow Japanese equities boasting a 33-percent increase.

Asian revenue has been held back by Hong Kong as, in contrast to the rest of the region,

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OCC has strong 2016

OCC saw an increase of 29 percent in new loans in December, ending a year of consistent growth in its securities lending central counterparty activities on a high.

The clearinghouse recorded 177,826 stock loan transactions last month.

January to December securities lending activity was also up 37 percent with almost two million new loan transactions. OCC's average daily loan value was $153 billion in December.

Total options volume in December reached more than 337 million contracts, which was down 3 percent from the same month in 2015.

Exchange-listed options volume was down 2 percent in 2016 with a little over 4.06 billion contracts.

Average daily options volume in 2016 was also down 2 percent with more than 16.12 million contracts.

OCC saw its futures contracts soar 56 percent in 2016, with more than 104.5 million cleared throughout the year.

"In 2016, OCC took great strides as the foundation for secure markets to enhance its resiliency by reducing the regulatory remediation gap and putting in place proactive policies and procedures to identify and resolve new problems," said Craig Donohue, executive chair and CEO at OCC.

"We also made great progress in strengthening our relationships with regulators and policy makers and in reaffirming OCC's position as a strong, visible advocate for the US listed options industry and market participants."

its beneficial owners stood to make a third less revenue from lending out equities than they did in 2015.

In the Nordics, every market beat its 2015 target, but Sweden stood out more than the rest with a 45 percent increase in revenue.

This was driven by a 22 percent increase in the demand to borrow Swedish equities as well as better pricing dynamics as the fees generated by these loans have increased by a fifth to 260 bps in 2016.

SEC settles shorting suit

The US Securities and Exchange Commission (SEC) has settled a first-of-its-kind cease-and-desist proceedings against the senior management of Wilson-Davis & Co, a Utah-based broker-dealer, for short selling violations.

The violation related to Regulation SHO, which requires that, before a broker-dealer effects a short sale, the broker-dealer must locate a source of borrowable securities that can be delivered on time.

The rule includes a limited exception for short sales executed in connection with bona fide market making, which Wilson-Davis leveraged between November 2011 and May 2013, despite it being inapplicable because much of the broker-dealer's proprietary trading activity was not legitimate.

According to the SEC, Wilson-Davis engaged in numerous short sales in over-the counter equity securities and willfully violated Rule 203(b)(1) of Regulation SHO and resulted in "improper trading profits".

This is the first time that the SEC has charged the CEO of a broker-dealer with violating the CEO certification requirement of the market access rule. The SEC handed Wilson-Davis CEO, Paul Davis, a $25,000 penalty for violating the certification requirement of the market access rule because "the certification was inadequate and he signed without being familiar with the rule, not knowing who at the firm was responsible for compliance with it nor making reasonable inquiries about the firm's annual review and the results of any such review".

Davis consented to the order without admitting or denying the findings and agreed to cease and desist from such violations. The SEC also charged the broker's vice president and head trader, Byron Barkley and Anthony Kerrigone, with similar violations.

Barkley was ordered to pay a disgorgement of $67,710.20, prejudgment interest of $8,977.83, and a penalty of $50,000, which he also accepted without admitting or denying the findings.

Kerrigone will pay disgorgement of $486,840, prejudgment interest of $63,160.50, and a penalty of $50,000 under the same terms.

“We allege that Wilson-Davis violated SEC rules that help ensure fair markets, including the rules for short sales and for market access,” said Andrew Ceresney, director of the SEC’s enforcement division.

“Public confidence in our markets depends on careful compliance with these market structure rules.”

Norway suffers short outage

Norwegian short sellers were unable to fulfil new short selling disclosure requirements due to the Norwegian Financial Supervisory Authority (NFSA) website experiencing ‘technical problems’.

Norway’s new short selling disclosure rules, which are similar to the EU’s Short Selling Regulation, came into effect on 1 January, with the relevant reporting platform due to launch on 2 January to receive the data.

But the Finanstilsynet website suffered technical issues between 3 and 6 January. It temporarily displayed the message: “Due to technical problems that prevent some users from completing registration and submitting positions, the short selling register might currently not disclose all positions legally required by the short selling regulation. Finanstilsynet is working on resolving these issues.”

The website is now working.

Under the new rules, a short seller must notify the NFSA if its net short position becomes larger than 0.2 percent of the share capital of the issuer.

If the position moves by 0.1 percent in either direction, then additional reporting is required.

Net short positions in Norwegian sovereign debt are also included in the reporting rules.

Short sellers are expected to disclose all relevant data by midnight on trading day and by 3:30pm local time on the following trading day for a change in net short position.

European banks pay for RMBS

The US Department of Justice (DoJ) has agreed settlements with two European banks over the sale of residential mortgage-backed securities (RMBS) worth more than $10 billion, and brought civil charges against a third.

Deutsche Bank has agreed to pay a civil monetary penalty of $3.1 billion and provide $4.1 billion in consumer relief in the US over five years. The settlement with Credit Suisse is similarly structured, but with a civil monetary penalty of $2.48 billion and consumer relief of $2.8 billion.

Both settlements, in principle and subject to approvals, are lower than expected. Deutsche Bank was widely thought to be facing a potential fine of $14 billion. The settlements will relieve Deutsche Bank and Credit Suisse of civil charges related to the securitisation, underwriting and issuance of RMBS up to 2007. Consumer relief is expected to be in the form of loan modifications and other assistance to homeowners and borrowers.

The DoJ has also filed a civil complaint against Barclays in the US District Court of the Eastern District of New York, accusing the bank of engaging in a fraudulent scheme to sell RMBS between 2005 and 2007.

According to the DoJ, Barclays personnel repeatedly misrepresented the characteristics of the loans backing securities they sold to investors throughout the world, who incurred billions of dollars in losses as a result of the fraudulent scheme.

ADX plans shorting platform

The Abu Dhabi Securities Exchange (ADX) is set to introduce a short selling service.

The exchange is engaging with brokerage companies in Abu Dhabi and Dubai to launch the service with the aim of making the market more attractive to foreign investors and boost overall liquidity.

As part of its technical short selling regulations ADX will require that the price of sold stock must be higher than the price of last deal price, or one unit higher.

If the price slumps 5 percent during the same trading session, the automatic short selling mechanism will be ceased for that trading session and the one on the following day.

Abdullah Al-Blooshi, ADX CEO, said: “The accounts allowed for short selling are only margin trading accounts and investors who obtained ADX acceptance to trade technical short selling, in addition to investment funds, institutional investors, custodian clients, and market makers. Bearing in mind that the door will be open for others who we ensure his/her financial and investing situation.”

Al-Nuaimi, head of the market operations and surveillance department, added: “Brokerage companies must be committed that the technical short selling is a (minus) purchase in order to be fully disclosed. Also, in the brokers’ books, a 20 percent of the deal will be added as a guarantee.”

“By the end of the day the brokers as well as the custodian will evaluate the stocks that were short-sold in accordance to its market value, and against the guarantee presented by the client. If the price is not equal to the market value, the clients will be informed to increase their guarantee. Otherwise the broker has the right to purchase the stocks.”

The suit also named two former Barclays executives as defendants.

Paul Menefee, who served as head banker on subprime RMBS securitisations, and John Carroll, who served as head trader for subprime loan acquisitions, are accused of violating the Financial Institutions Reform, Recovery and Enforcement Act, based on mail, wire and bank fraud, and other misconduct.

“The widespread fraud that investment banks like Barclays committed in the packaging and sale of residential mortgage-backed securities injured tens of thousands of investors and significantly contributed to the Financial Crisis of 2008,” said principal deputy associate attorney general Bill Baer.

“Millions of homeowners were left with homes they could not afford, leaving entire neighbourhoods devastated. The government’s complaint alleges that Barclays fraudulently sold investors RMBS full of mortgages it knew were likely to fail, all while telling investors that the mortgages backing the securities were sound.”

“Today’s complaint makes clear that the DoJ will continue to hold financial institutions, and the individuals who work for them, fully accountable for harming investors and the American public.”

Barclays said it rejects all of the claims made in the DoJ’s complaint.

“Barclays considers that the claims made in the complaint are disconnected from the facts. Barclays will vigorously defend the complaint and intends to seek its dismissal at the earliest opportunity,” the bank said in a statement.

OneChicago on a roll

Securities finance exchange OneChicago has posted its fifth consecutive record-breaking year for trading volumes, beating its 2015 target by 6 percent.

Strong annual figures were curbed by a 9 percent fall in December volume, compared to the previous year at OneChicago, with 1.3 million transactions.

Overall, OneChicago’s Q4 data remained positive with a 15 percent increase on 2015’s figures.

Open interest decreased 1 percent year-over-year to 657,288 contracts as of 30 December.

The exchange's flagship OCX.NoDivRisk continued to dominate its business with 98 percent of December month-end open interest being in these products.

Euronext bids for LSEG asset

Euronext has placed an "irrevocable all-cash offer" for the London Stock Exchange Group's (LSEG) majority stake in LCH.Clearnet SA, the French arm of LCH.Clearnet Group.

LSEG and and Euronext agreed a put option and a cash consideration of €510 million, on the condition that the merger between LSEG and Deutsche Börse is completed.

The sale of LCH.Clearnet SA was recommended by European Commission in order to address anti-trust concerns in relation to certain businesses and would be subject to review and approval.

The offer comes after Euronext first expressed an interest in the subsidiary in December.

NSD tests repo collateral service

Russia's National Settlement Depository (NSD), in collaboration with Bloomberg, is testing a new collateral management service for over-the-counter repo transactions.

The service will allow repo transactions to be processed with securities baskets through NSD's collateral management system.

The commercial launch is scheduled for March 2017. The service will mirror the process currently used by the Bank of Russia, Federal Treasury and general collateral certificates for on-exchange repo activity.

NSD saw the value of repo transactions with the Russian Federal Treasury through its collateral management system more than double in Q3 2016.

NSD's clearing value for the quarter exceeded RUB 10 trillion (USD 159 billion), up from RUB 4.6 trillion (USD 73.12 billion) in Q3 2015.

The depository's recorded transactions increased to 495 from 334 year over year.

The value of NSD's repo transactions with the Bank of Russia conducted through the system dropped significantly in Q3 2016, compared to the same period in 2015.

Cleared repo between the central bank and NSD stood at RUB 3 trillion (USD 47.7 billion), down from RUB 8.1 trillion (USD 128 billion).

TD Securities seals AF&Co deal

TD Securities has completed its acquisition of securities lending technology platform Albert Fried & Company (AF&Co).

AF&Co's services also include self-clearing and a prime brokerage technology platform that is expected to launch in 2017.

The acquisition began in September 2016 and marks the next step in TD Securities's US growth strategy.

"We are pleased to successfully complete this transaction," said Glenn Gibson, senior vice president & vice chair, TD Securities US.

"The acquisition of AF&Co's services and capabilities will expand our offering, strengthen our US business and accelerate our growth."

Eurex Clearing ends on a high

Eurex Clearing's repo volume increased by 2.6 percent in December.

The Deutsche Börse subsidiary recorded an average monthly outstanding volume of €31.4 billion last month, up from €30.4 billion during the same month in 2015.

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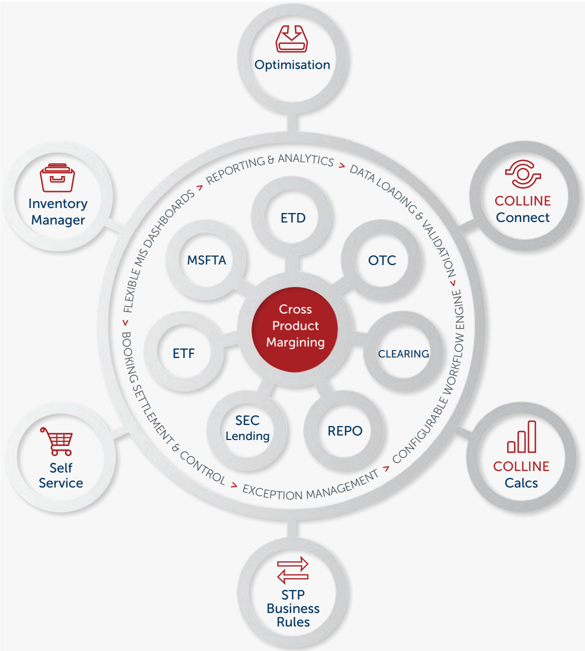

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Eurex's GC Pooling segment suffered a 34.4 percent decrease year-over-year.

Average monthly outstanding volume dropped from €112.1 billion in 2015 to €73.5 billion a year later.

Ireland prepares for post-Brexit influx

The Central Bank of Ireland is preparing for the possibility of financial services firms relocating from the UK to Ireland when the UK leaves the EU.

In an article written in late December and published in Finance Dublin in January, Gerry Cross, director of policy and risk at the Central Bank of Ireland, said the bank has "no objection to thinking constructively" about the challenge facing firms with regards to relocating in what could be a relatively short timeframe.

Cross said: "Many financial groups based in the UK are considering what changes they might need to make to reflect the changing relationship between EU and the UK."

The central bank is engaging with financial services firms, considering potentially authorising and supervising those considering a change to their "group structural and geographical arrangements for a post-Brexit world". According to Cross, the central bank has already seen "a material number" of enquiries related to the UK's vote to exit the EU. Although most of these have been of a preliminary nature, some have advanced.

He suggested that financial services firms looking for authorisation in Ireland will find the bank to be "engaged, efficient, open and rigorous". However, the time taken to process any application will depend on the licence being sought, the approach of the applicant, the extent to which it can be standardised, and the complexity of the procedure.

The central bank will need to be satisfied that the business, or line of business, under authorisation will be run from Ireland. Cross said: "We will expect there to be a substantive presence."

This means the board and management should be based in Ireland, and decisions are taken there.

"Another way of looking at this is that we will want to be very clearly satisfied that the risks that are associated with the business of the entity are governed, remunerated, managed and mitigated in and by that entity," he said.

Cross suggested that the central bank will also focus on a firm's own understanding of risk in its business model, and how risk is managed and mitigated.

"We also seek to ensure that the customer's interests are central to the business proposition, from the suitability of products to the treatment of claims. This is the role of a regulatory authority," Cross said.

"Proper business models, with convincing risk identification and management, focus on consumer needs, suitable products, sound finances, strong boards and executives, can be expected to be approved, whether or not such business models already exist in Ireland."

With regards to insourcing and outsourcing practices, Cross said the bank has no particular issue with this "up to an appropriate point".

However he noted that insourcing and outsourcing can be a source of risk, and that this is something the central bank will consider.

Cross explained: "In particular, we will be focused closely on the principle that while an activity may be outsourced, responsibility for it may not. We will always want to see that there is the level of expertise and seniority

within the entity to effectively oversee and manage such outsourcing."

Finally, Cross addressed the central bank's ability to cope with the potential of a high volume of applications over a short period of time, and to carry out the oversight required, stressing that planning for 2017 "reflects the additional resources needed".

He concluded by recognising that financial services firms are facing complex decisions with far-reaching implications, as well as practical constraints if they decide to relocate.

"A key component of a successful and attractive jurisdiction for the location of financial services activities is a strong and independent regulator, with international credibility. Delivering this is, in my view, by far the most valuable contribution that the central bank can make to the attractiveness of the jurisdiction as a location for financial services firms."

However, Cross also stressed: "Regulatory competition should not be a determining factor in where firms choose to seek authorisation", adding: "The Central Bank does not have a role in seeking to attract business to Ireland."

Deutsche Börse builds Tradegate stake

Deutsche Börse is increasing its stake in Tradegate, a securities trading bank, to almost 20 percent.

The financial services group is conducting its third and final call option of Tradegate shares in order to build on its current stake of approximately 15 percent.

Deutsche Börse previously increased its initial 5 percent stake to 15 percent in 2014.

Tradegate is an active liquidity provider on a number of German exchanges.

BNP Paribas has held a mandate to manage its securities services, including securities lending and clearing activities, since July.

Deutsche Börse also acquired a 75 percent stake in Berlin-based Tradegate Exchange in 2010, along with Tradegate.

EU confirms CCP parity for six markets

The European Commission has recognised the regulatory standard of central counterparties (CCP) based in six global markets as being EU equivalent.

CCPs in Dubai, India, Brazil, New Zealand, Japan and the United Arab Emirates are all now considered to be of "internationally-recognised best practice".

The allocation will allow for smoother activity between CCPs in the equivalent markets by cutting red tape in cross-border business.

The move is expected to open up new liquidity sources for EU asset owners and improve collateral management efficiency at a time when many are predicting a shortage of high-quality liquid assets in the short to medium term, caused by the latest wave of EU regulatory requirements.

The latest additions will join already recognised regimes including those in the US, Canada, Switzerland, Australia, Hong Kong and Singapore.

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The first year under SFTR has seen a sophisticated dialogue develop between ESMA and the market, which could set the standard for the future

The Securities Financing Transaction Regulation (SFTR), which began its implementation process in January 2016, will receive its final technical standards in Q1 2017 and the 12-month window to prepare for phase one will begin to close.

The new framework, aimed at improving market transparency, still has some features under construction as others come into effect, meaning the European Securities and Markets Authority (ESMA) is still receiving a plethora of comment letters from market participants seeking greater clarity on upcoming standards.

SFTR will require UCITS and alternative investment funds to report their use of securities financing transactions and total return swaps in the annual report of every UCITS or alternative investment fund under management, and in each six-monthly report for UCITS.

This information must be included in the first annual or six-monthly report published after 13 January 2017, although this may include a reporting period beginning before January.

A review of the first year of business under the SFTR umbrella reveals the emergence of a strong relationship between ESMA and market representatives. The ongoing negotiations included multiple consultations and redrafts as ESMA has involved interested parties at each stage of the process, instead of simply passing down a tablet of new commandments from on high. The collaborative process has allowed for all parties to express their respective aims of market stability and business continuity.

The market speaks

Following the first January 2016 implementation date, the International Capital Market Association (ICMA) published a statement calling on the regulator not to overreach in its reporting requirements at the risk of straying into collecting redundant information or overlapping with existing reporting frameworks.

"While we acknowledge and welcome the explicit exemption from Markets in Financial Instruments Regulation (MiFIR) reporting requirements of all transactions that will be reported under SFTR, we also note that this exemption does not extend to SFTs that have been explicitly exempted from SFTR reporting, in particular SFTs with European System of Central Banks counterparties," ICMA explained in its statement.

"We strongly disagree with this approach as we believe that the SFTR provides the only appropriate framework to report SFTs and that the inclusion of the aforementioned transactions in MiFIR transaction reporting goes against the clear political decision to exempt these trades from SFTR reporting obligations," ICMA added.

The potential for inconsistencies in technical terms and standards across similar reporting regulations also featured prominently in the list of concerns initially raised by industry bodies.

The International Securities Lending Association (ISLA) submitted its own response letter to the Financial Stability Board's (FSB) proposal for implementing stability measures for the 'shadow banking' sector, in which it highlights inconsistencies between ESMA's and the FSB's definition of certain aspects of the securities lending market.

And the regulator listens

After receiving a deluge of industry comment, a well-informed ESMA smartly sidestepped one of the industry's worst fears of creating a 'major liquidity issue' by revising its collateral reporting rules in its second-level consultation, published in October 2016.

Specifically, the requirement to report on collateral used as part of an SFT on a T+1 basis was amended to make the deadline for reporting the day after value date.

Ben Challice, COO at Pirum Systems, explained: "Clearly you don't know what you're going to use as collateral until the value date of the collateral requirement."

He said: "ESMA seems to have listened to the market and now acknowledges that to lock up collateral before moving it would create major liquidity issues in the market."

"They have now proposed that it can be reported on value date plus one for non-cash trades (pending further consultation)."

ESMA acknowledged that it had learned much since it first began drafting the reporting standards for the European Market Infrastructure Regulation (EMIR), on which SFTR's own requirements are largely based, and saw the need for improvements as a result.

"[The authority] understands that with the exception of trades against a collateral basket both counterparties will have agreed the collateral for an SFT at the time the SFT is concluded or at the latest at the end of the day on which the SFT is concluded," explained ESMA in its September 2016 consultation paper. "For repo trades against a collateral basket, the counterparties would report the collateral allocation as soon as it is known, but at the latest at the end of the value date plus one."

SFTR implementation timeline

January 2016	**SFTR comes into force**	Only some rules apply: • Record-keeping requirements; • Transparency requirements for pre-contractual documents for new funds; and • The obligation to establish internal procedures for reporting breaches apply.
July 2016	**Collateral reuse requirements**	Collateral reuse requirements • Reuse requirements apply. • Retrospectively applies to existing collateral arrangements.
November 2016	**Final industry consultation**	• ESMA published a consultation paper on the reporting standards on 30 September, with a deadline of 30 November 2016.
Q1 2017	**SFTR final technical standards**	• Final text supporting the implementation. • Needs to be adopted by the European Commission, Parliament and Council, and then published in official journal. • Obligation for reporting begins one year after the publication of the final text.

Source: IHS Markit

ESMA also used the second-level consultation to respond to the market's concerns around consistency and reiterated its aim to "ensure a level playing field" for market participants' access rules and "align reporting standards to the maximum extent possible" across the various EU reporting regimes.

According to ESMA, this required two amendments to EMIR's technical standards on reporting, plus detailing the operational standards for data access, comparison and aggregation. Although SFTR and EMIR are primarily focused on the EU, the nature of the reporting requirements will affect global entities that interact with the EU market for securities lending activities.

Fran Garritt, director of securities lending and market risk for the Risk Management Association (RMA), said: "The RMA Securities Lending Committee is monitoring SFTR as many US agent lenders and beneficial owners will be impacted by SFTR reporting rules due to the global nature of the business. Most US agent lenders service European clients, and both US agent lenders and beneficial owners lend both to European counterparties and European securities."

The feedback ESMA received from this consultation will now be used to form the draft technical standards. They will be submitted to the European Commission by the end of Q1 2017. The final version of SFTR will come into force from 2018.

The market responds

Before this happens, market participants should take note of the various vendor solutions that are being released to help tackle SFTR's reporting requirements.

IHS Markit's fully hosted data and reporting solution provides the foundation needed to reconcile trading activity down to the unique trade and legal entity identifier (UTI and LEI) level of granularity. It also offers turnkey connectivity to trade repositories.

Features include a trade warehouse that pulls data from multiple sources and provides a standardised copy of all trading and collateral activity.

A real-time module reconciles trades and creates the SFTR mandated-UTIs at the LEI level, with a full audit trail of the process including matching status reports.

IHS Markit's solution is the latest in a line being rolled out to deal with the SFTR reporting requirements. According to post-trade provider Pirum, SFTR reporting will be on a T+1 basis in line with existing regulatory reporting regimes.

It mandates two-sided reporting, with both the collateral giver and taker required to report their side of the trade to a registered repository.

As part of the two-sided reporting obligation, a UTI must be included in their reports. "This value will be used by the trade repositories to match separately received reports from each counterpart to [a trade]," Pirum explained.

Pirum is leveraging its existing contract compare functionality to generate the UTIs needed for transaction reporting. It promises that generating UTIs from positions matched in Pirum will ensure that trades submitted to repositories will have a higher matching rate once reconciled, reducing the amount of incorrect reports that counterparts need to review.

EquiLend recently revealed that it too is working on a solution to meet the reporting requirements for trades and collateral under SFTR. It is talking to market participants to gauge how best to tackle the requirements.

The trading and post-trade service provider already captures much of the information required by SFTR, meaning it can create the UTI immediately either at the point of trade or during the post-trade comparison process. **SLT**

SFTR reporting roll-out

Q1 2018	**Phase one**	Only applies to: • Investment firms and credit institutions.
Q2 2018	**Phase two**	Addition of: • CSDs and CCPs.
Q3 2018	**Phase three**	Addition of: • All other financial counterparties.
Q4 2018	**Phase four**	Addition of: • All non-financial counterparties.

Source: IHS Markit

A move to a new 'new normal' in financial markets?

In the first of a two-part special, Allen & Overy's Michael Huertas and Kai Andreas Schaffelhuber look at the consequences of a tumultuous 2016

A lot has changed over the past year with financial markets seeing a fair amount of turmoil. The bounce-back and the weathering of volatility have made for challenging markets. A range of systemic, political and macroeconomic important events have shaped 2016 and will ultimately shape 2017. These range from fears around a slowdown in China, troubles in the Italian banking sector, which many fear could make Greece a 'sideshow', and a general rise of populism and anti-establishment politics.

These fears have also spilled over into the banking sector, culminating in profitability stresses from new disruptive threats to business models, lower for longer interest rates and non-performing exposures into other asset classes. However, in comparison to markets in previous years, performance has generally held-up. Nevertheless, it has been a busy year, and that was before one even looked at what was happening in EU legislative and regulatory work-streams.

The 'regulatory pause' that a number of European market participants and stakeholders called for in 2015 with a view to advancing supervisory calibration, ie, harmonisation of rules and processes to existing rules or concrete proposals, did not materialise in 2016. What did surface was further clarity around the 'end state' that EU policymakers are committed to advancing. Part of this is detailed in the EU's capital markets union (CMU) project that started in September 2015 and was extensively promoted during 2016 to ensure it advances with sufficient impetus. The other part saw the finalising of the first two pillars of the banking union and delivery of key regulatory initiatives to create more resilience in the eurozone banking sector.

All of these items were also tied together by overarching initiatives, including the EU's 'better regulation agenda', which is to be put in practice on CMU and non-CMU led regulatory work-streams. It remains to be seen whether this 'better regulation' agenda, when put into practice, will have a transformative effect on how markets are traded. It also remains to be seen whether it will allow for easier delivery of regulatory change, both across 'change the business' and 'run the business' projects/work-streams in various thematic areas where regulatory change is moving from concept design to the implementation phase.

> In comparison to markets in previous years, performance has generally held-up

During 2016, planning and preparing for implementation of core items such as the second Markets in Financial Instruments Directive/Regulation (MiFID II/MiFIR), the European Market Infrastructure Regulation (EMIR) review, and the Securities Financing Transaction Regulation (SFTR), saw the move of these work streams from 'horizon risks' to firms and project teams hunkering down. 2017 is unlikely to be any different.

Making waves across the channel

The EU woke up to a very different reality on the 24 June, following what for many seemed a sure bet that the British electorate was marginally backing its participation in the EU project. Brexit has introduced a new wave of uncertainty. It has also put the brakes on, both in the UK and the rest of the EU, a number of decisions while others are on the backburner pending clarification on direction of relationships on both sides of the English Channel and the Irish Sea.

This uncertainty has begun to have some real effects. Aside from costlier Marmite and slimmer Toblerones, it has triggered 'Brexodus', a term used to define the reallocation of financial services (and other) activities away from the UK and generally to other EU member states, and scenario planning for those firms wishing to 'Brexit-proof' their business, regardless of whether they remain or leave the UK. For those remaining EU members, the UK's domestic disagreement on a 'hard' or 'soft' versus flexible Brexit is testing patience. The recent changes in the US have also raised questions on the future 'end state' of regulation that the US is moving to and what that might mean for European markets and the worldwide competitive position of the continent's credit institutions.

This political ambiguity has ushered in a new 'new normal' following the one last seen in the aftermath of the great financial crisis. Absent a regulatory pause, this uncertainty risks affecting the pace and content of regulation and that can cause fragmentation rather than harmonisation to take root. To further complicate matters, a number of regulatory workstreams are now moving at quite different speeds of change. All of this affects how markets are traded, how documentation and compliance are approached by those supervised entities as well as non-supervised market participants. These all have important effects for those engaged in securities finance transactions (SFTs) and financial markets more generally.

The continued pace of regulation: a risk of greater fragmentation than harmonisation?

Even prior to the Brexit referendum, the EU has now found itself moving to a two-speed Europe.

One where the eurozone core is integrating deeper and making its own eurozone-specific rules that harmonise regulation and the rest of the EU, where harmonisation and convergence is advanced across some 'total-EU' projects, including the CMU but on others, looser cooperation is put forward as a palatable alternative to calibration and convergence for those non-eurozone member states.

While this reflects in many ways some of the political realities of 2016, it does affect those cornerstone pieces of EU regulation, such as prudential capital regulation but equally SFTR. Since SFTR's entry into force on 12 January 2016, it has contributed to creating uniform rules and standards of conduct in relation to the markets and market participants engaged in SFTs.

This is vital as the SFT markets, operations, processes, as well as the documentation and contractual master agreements that underpin their functioning, have varying degrees of fragmentation in rules and processes and some have more to do to meet SFTR compliance. A number of these operations and processes are already in scope of other pending global, EU, eurozone or national-specific reforms. Not all regulatory concepts established in one area exist or are replicated in another area.

These divergences add to, or even accelerate, risks that gaps and inconsistencies could contribute to 'conceptual translation risks'. Brexit complicates this exercise by introducing variability in the degree of fragmentation. With the bulk of SFTR's provisions starting to enter into force during 2017 and onwards, those risks, unless controlled, can exacerbate costs, inefficiencies and further drive fragmentation as opposed to harmonisation.

In many ways, fragmentation can be seen to be a goal that regulation seeks to tackle but can also (at the same time) be a product of it.

As a result, some market participants may also need to further 'Brexit proof' themselves. In part this might mean adopting a comprehensive yet concentric compliance approach.

This is especially the case as the UK, post-Brexit, may increasingly move to distinct UK rules from the 'twin-peaks' of the Financial Conduct Authority and Prudential Regulation Authority, some of which may not be equivalent to EU or global rules.

For firms, regardless of where they sit in the EU or the UK, compliance, legal and trading terms need to more joined up in 2017 as supervisory engagement sets to be more intrusive. **SLT**

The second part of this article, which will look at the practical impact of this uncertainty from the perspective of SFTR, will be published in the next issue of Securities Lending Times.

Some market participants may need to further 'Brexit proof' themselves

The tipping point

Deutsche Börse's breakfast seminar in London saw experts call on the industry to continue its commitment to the central clearing project

Deutsche Börse's breakfast seminar provided a unique opportunity for securities lending participants to meet and share their experiences of traversing the various stages of connecting with Eurex's Lending CCP.

A panel of industry representatives from BNY Mellon, Morgan Stanley, BlackRock and Barclays, which are all at different stages of implementation, spoke openly and honestly about what attracted them to the central counterparty (CCP) project and the challenges, both internal and external, they are facing in guiding their respective firms through the process.

The session was moderated by Ben Chalice, COO of Pirum Systems, which has partnered with Eurex on voluntary corporate actions services, meaning that, once the introductory speeches were over, there was no direct Deutsche Börse influence on the discussion.

By hosting a panel of CCP converts, the debate was able to avoid getting bogged down in the unanswerable chicken and egg-style debate about necessary volumes that too often dominate conference panels.

During the session it was revealed that panellists had arrived at the same destination by very different paths, and with a variety of motives driving them. However, the obstacles they faced along the way were all too familiar, allowing speakers experienced in implementation to educate audience members and offer solutions that best worked for them.

Concerns around managing the significant IT lift at a time when operations teams were also being asked to produce regulatory compliance solutions were aired, along with legal and compliance issues around collateral visibility, and the age-old question of cost.

The mood of the session was positive. Many early movers are expecting to complete coupling with the CCP in the first half of 2017, and that will likely put to bed many of the criticisms levelled at central clearing models. As was noted during the panel, once firms start to cross the finish line, they will be able to lend valuable clarity and metrics to those behind them.

Ultimately, volumes may still not be where the CCP faithful would like them. But 2016 did see a decisive turning-point in the 'hearts and minds' campaign aimed at the winder securities lending industry. Hardened CCP sceptics, who had until recently been vocal critics of the central clearing model, were willing to go on record during conference panels and acknowledge the inevitability of a CCP's establishment in the market.

For those who have been campaigning for CCPs and those in the vanguard of implementation, 2016 was a watershed year that will add significant momentum to the cause.

Here the day's discussions are repeated in full so that readers can judge for themselves the benefits and drawbacks of the CCP and hopefully learn how to overcome any challenges that they may be facing.

Erik Müller: Deutsche Börse has recently undergone a significant reorganisation focused on allowing all the various segments of the organisation to work in a more integrated way and to increase our proximity to our partners.

We want to understand how to utilise all of these assets in what is now known as our global funding and financing business to solve the industry's issues.

A lot of these challenges are driven by regulation, which is changing the rules of the game as we know them.

The industry will have to adapt, and we want to approach that change hand-in-hand with all our partners going forward.

Deutsche Börse Group has committed tremendous resources over the past few years in extending its geographical reach, asset class coverage and technology base.

Our new T7 trading system, along with our clearing system, C7, which launched in May 2016, and the risk management system, Prisma, are all cutting edge technologies in our industry.

This allows us to present ourselves as a strong partner to anyone in the market. We want to be the best we possibly can be, but we in turn need invested partners to work with us and match our enthusiasm to make new offerings commercially viable.

In the securities lending industry, we are getting very close now to achieving our aim of creating a proposal that solves issues throughout the transaction chain for both sides of the trade.

All of this represents a full body of work that we have achieved in 2016 and I'm very pleased to say we've received full support from our board to further finance these initiatives in 2017. But we still need our partners to be with us every step of the way to guide us and lend us their expertise, and to make sure this is a success for everyone.

In this panel, we have representatives from some of those same partners who are all at different stages of implementation of the Eurex Lending CCP and are willing to share their experiences so far.

Deutsche Börse in 2016

- Building out title transfer with immediate pledge back for compliance with UCITS V
- Connecting with EquiLend as a flow provider
- Partnering with Pirum on voluntary corporate actions
- CCP balances increased to between €2.5 billion and €3 billion

Looking ahead to 2017

- UK market will be added to existing five European markets
- BNY Mellon connection to open in Q1 2017
- Target2-Securities will allow for clearing in Italy, Austria, Denmark and Finland
- Triparty netting solution for beneficial owners expected in November 2017

Ben Challice: What do you see as the key benefits of a CCP?

Matt Collins: As a firm, we've taken a very top-down approach to how we think about central clearing. That means across the firm, looking at the direct drivers coming through new regulation and the subsequent needs of our clients, to the indirect drivers such as increased use of financial resources in our businesses and capacity reduction in the market. What we see is that a CCP can create that capacity and bring down our resource use at the same time.

Our starting point for this journey, from a securities finance transaction (SFT) perspective, was to address the binding constraints that were starting to hit us, such as leverage, risk-weighted assets (RWAs) and wider capital planning. From there, we started to look more laterally at the secondary benefits.

So what started as a more straightforward leverage and capital solution has evolved into a wider embrace of everything that's on offer. As more stakeholders got involved, we quickly realised there was an opportunity to seize some very significant operational benefits as well. There are upfront costs to moving to a CCP model, but we're predicting benefits that offset that and materially improve how we run our business.

Peter Foley: We definitely didn't start from the top down. My initial reaction was that this might be a good RWA solution. I still see some benefit there but I don't see it being a game changer, given some of the other projects we have going on in that area. In terms of balance sheet optimisation potential, it's the same. I don't see that we're going to get huge netting benefits from this side of our business.

That said, one significant benefit I do see coming from a CCP is greater access to funds. Barclays has always tried to be a leader in the market in terms of netting applicability and this is something that will give me visibility of assets that I wouldn't get otherwise.

Furthermore, when you start to scale this aspect up, it becomes very interesting to me. If Eurex also creates a really efficient product that offers all sorts of operational savings, then I'm even more interested.

Challice: Is it a case of a 'chicken and egg' scenario, in that you're waiting for enough liquidity and scale on the platform but that only comes with active members?

Foley: Yes, absolutely. Personally, I'm convinced, but it makes it a much easier sell when I go to our new product committee if it's as close to a plug-and-play product as possible. I accept it will never be exactly that, but the more liquidity and the closer it is to the finished product, the easier it will be to sell.

> The more liquidity the CCP has and the closer it is to the finished product, the easier it will be to sell to our new product committee

Peter Foley
EMEA head of SBL trading for equities
Barclays

Tim McLeod: For us, it's more than just borrower demand driving our engagement. As an agent lender, we view this as an opportunity to transact with a high-quality counterparty in Eurex, and one that assumes the majority of the operational heavy lifting as well. From a counterparty credit, operational efficiency, scale and risk perspective, it's an attractive proposition. The other aspect for agent lenders to consider is whether lending through a CCP makes for a more cost-effective transaction, which is something we're exploring.

Apart from all the benefits we've mentioned, the other factor to consider is commercial—the risk of not entering the clearing space. This is a multi-year effort and we as an industry have been discussing it for a long time. But there will come a point where the large counterparties that agent lenders trade with bilaterally will only do certain trades through a CCP, and if you're not in that space then you're going to start to see utilisation drop. For me, that is a key incentive to not stand still on this.

Simon Tomlinson: It's certainly been a long process from something that was very sell-side focused at the beginning to what we have now. It was back in March 2015 that BNY Mellon and one of its peers announced a strategic partnership with Eurex to help re-shape the CCP model to better suit the buy side and now we are very close to seeing the benefits of that relationship come to fruition. The key benefit is that the CCP offers an additional route to market for our clients, which is crucial because regulatory changes have led to a constrained market.

Challice: How are the various costs of entering the central clearing space being analysed and absorbed?

Collins: First of all, it's quite difficult to fully analyse something when it is still in its infancy, it's more of a judgement call but we see it as the right thing. The operational lift of connecting was fairly heavy, and at the time, we needed a lot of stakeholders involved. We took a bigger picture view with consensus to pursue this initiative, given its future potential to add capacity to a business that's currently constrained by leverage and capital requirements. Now, looking back, we're seeing the benefits and are extremely pleased that we have invested in this initiative.

Foley: We're not as far down the path as some others and we haven't done that level of analysis. As a firm, we're still there to be convinced. My own thinking is that there is a 'future unknown' factor to consider in terms of the possibility of mandatory clearing. If I knew this was going to be mandated in the future, I'd like to be further down the road than I am now. As I mentioned, I don't see major RWA or netting benefits right now, but that could change. I'm open to the concept. In the meantime, if the margins came down, it would make for a much easier cost/benefit analysis.

> The key benefit is that the CCP offers an additional route to market for our clients, which is crucial because regulatory changes have led to a constrained market
>
> **Simon Tomlinson**
> **Regional head of EMEA equity trading**
> **BNY Mellon**

Challice: Simon and Tim, what is the buy-side level of interest from your clients?

Tomlinson: At this time I would say it is mixed. Some clients are very engaged and can see the advantages that a CCP can bring to their lending programme, while others are watching the developments with interest but are not willing to make any commitments at this time. We have a handful of early adoption clients that are on track to go live in Q1 2017. However, for example, due to jurisdiction or fund type restrictions some of our clients will be more applicable than others.

Beyond that, we're hopeful that once there is an established 'proof of concept', more clients will be able to see the benefits.

McLeod: Because of the nature of the majority of clients that we lend on behalf of, namely large pooled funds, a key part of our job is to help explain the CCP to the appropriate fund boards, focusing not only on the benefits but also ensuring that we remain focused on how the risk profile of their securities lending activities might be changing. We are very early on in that process.

Challice: How did you get the process started?

Collins: Our first step was to model exactly what this new product would look like. We had our technologists involved to assess the product from a connectivity point of view and they spent time with the flow providers to make sure we could clearly see how the process would work. Then we worked with our operations team on the detail.

Secondly, we engaged our corporate actions group, legal counsel and tax advisers who worked with Eurex and our partners in the market on the rule book. We needed to fully separate the idea of the legal counterparty, Eurex, with the order placer, because that needed to be more clearly defined, then to look at the tax perspective. It needs to feel similar to a global master securities lending agreement from a risk perspective, yet reflect the new legal arrangement with the CCP. This will evolve and be refined with time, but represents a new chapter in how we think about standardisation.

Challice: How will your operations teams tackle the margin and processing challenges?

Tomlinson: At the outset we will be going down the non-cash route, so there won't be a requirement to post margin. From an operational processing perspective there is no doubt this will be challenging depending on which vendor platform you use and the real-time processing requirements placed on internal platforms.

At this time we are currently working on creating the models that will allow us to use the CCP through the specific lender licence.

> We needed to fully separate the idea of the legal counterparty, Eurex, with the order placer, because that needed to be more clearly defined
>
> **Matt Collins**
> **EMEA head of securities lending and bank resource management**
> **Morgan Stanley**

McLeod: The plan is to use the specific lender licence, but first and foremost, we're spending a lot of time with our legal and compliance departments getting a firm hold on whether we can actually contract with the CCP under the proposed model before getting too far down the path of building out the operating model.

The regulatory framework can vary significantly—for example, UCITS funds compared to insurance companies—and we're trying to figure out which of our clients will be in a position to avail of CCP connectivity. Bearing in mind, for example, the title transfer with security interest collateral proposal, or certain alternative investment fund or UCITS depository obligations, which may not yet sit perfectly within the CCP model.

Once we secure a subset of our client base that can enter the cleared space we can accelerate the operations and technology phase. Our operations teams will need to embed the CCP model into their existing process, and develop more of an oversight role bearing in mind Eurex's management of the lifecycle events. In terms of technology, like everyone in the market, we have competing priorities to consider, such as our Securities Financing Transactions Regulation solution, which may affect our timeline. Our third key workstream involves our risk teams, who are looking into the default waterfall model to learn exactly how that would work in the event of clearing member insolvencies.

Challice: How are you feeling about CCPs going forward?

Foley: A huge amount of progress has been made and the fact that firms are deep into the research and are likely to begin implementation next year means that we can really start to build momentum.

Collins: We are now at the stage where people have already been through the process and can now offer guidance to those behind them, which is a big help for people in my position.

Tomlinson: We are in phase one of the evolution right now and we at BNY Mellon have invested a lot of time in this. It has been very encouraging to see the number of people who have come into the CCP conversation this year and this will ensure more engagement and ideas will be shared as we move closer to a 'buy-side' SFT clearing reality. There's already a clear benefit, but for us the biggest positives are yet to come. The addition of the UK in 2017 will be a big win for this community and will provide an outlet for this traditionally low-margin market to see more volume.

Another crucial point about the CCP initiative is the anticipated move to a multi-allocation model.

This will ensure more scalability and stability in the supply available and lead to a real gear shift in the level of clearing. **SLT**

> We're spending a lot of time getting a firm hold on whether we can actually contract with the CCP under the proposed model

Tim McLeod
E-trading and market structure
BlackRock

Watch your step in 2017

Richard Colvill of Consolo offers a four-letter breakdown of all the fast-approaching regulatory deadlines that are due this year

This year should be an interesting one. Many of the regulations that we have all been focused on for what seems like forever will kick in and we, and the regulators, will see the impact they will have. Whether its MiFID II, SFTR, CSDR, EMIR, BRRD, or any other four-letter acronym you can think of, 2017 will be a year of Challenging Regulatory Assessment and Performance (or keeping the theme of four letter acronyms, CRAP).

In all seriousness, some regulations, such as the European Market Infrastructure Regulation (EMIR), have the potential for significant impact on the securities financing markets, even though they relate to a different aspect of the financial services industry. The regulators have made it clear that the collateralisation demands EMIR enforces can be met by the market and assume it will be moved via financing structures to meet the demands. How this will affect demand as more firms come under the collateral requirements, only time will tell, but it could be positive.

Others, such as the Markets in Financial Instruments Directive and Securities Financing Transaction Regulation, require huge investment from firms. There are no obvious new opportunities, just a huge logistical and technical challenge and a hefty bill—although effective utilisation of the data internally could identify otherwise missed opportunities.

One of the biggest challenges will be how to meet all of the regulations without breaching others—there are a number of potential conflicts as well as some requirements that are open to interpretation and so run the risk of being applied differently.

The securities finance markets have met many challenges in the past and have always found a way to continue to function and make money, and I am certain this will be no different in 2017, but the number of significantly changing regulations has the potential to create the perfect storm. Meeting the requirements and keeping the business viable will be a challenge for some, if not all market participants, and has the potential to significantly change the industry landscape. Some participants will choose alternate market access or to re-think their strategic positioning in the market.

The weight of impact is likely to be relative with a disproportionate burden falling on smaller firms that don't have the economies of scale or IT budgets to spend, as well as operations world where a lot of the requirements will need to be met.

We will have a better view of the overall impact by 2018 and there is little doubt that the way firms undertake this year of CRAP will define the way the market looks and functions for years to come. **SLT**

> The requirements have the potential to significantly change the industry

Richard Colvill
Managing partner
Consolo

Under pressure

Experts debate the likely effect of monetary policy on repo markets

With the European Central Bank committed to continuing its asset purchase programme until December 2017, what is your prognosis for the health of the European repo market over the next 12 months?

Godfried De Vidts
Chairman
ICMA European Repo and Collateral Council

The asset purchase programme is only one of many ingredients that markets need to keep in mind in 2017. Untangling its specific impact is difficult, but the day-to-day strains seen in repo markets make plain the pressure on this product. Another facet of quantitative easing is negative rates, hence the difficulties for banks, and repo markets, to make cash work. Both elements may continue to undermine the repo market's capacity to prove an automatic stabiliser in future systemic stress situations.

The flood of regulations has certainly created unintended consequences. In recent weeks, the buy side has voiced concerns about the lack of sell-side market making, a function the buy-side will never itself replace.

Positively, the professional repo community has worked diligently through the International Capital Market Association's European Repo and Collateral Council, providing a pragmatic market response to the spate of new challenges. The participation of buy-side firms, which is expected to increase, will help to find further ways forward in 2017 and beyond.

Discussions with the official sector, whether central banks or regulators, focus on the clear evidence of balance sheet rationing and idiosyncratic pricing that may force policymakers to reconsider some of the new regulation. The capital markets union offers a chance to establish a well-regulated yet dynamic market. Appropriate re-calibration of this DNA of modern financial markets is essential to efficient capital allocation.

David Lewis
Senior vice president
FIS Astec Analytics

By continuing the asset purchase scheme until the end of 2017, and potentially beyond if the inflation requirements have still not been met, the asset purchase programme will continue to starve the repo market of much-coveted high-quality liquid assets. At present, it is said that together, the European Central Bank and the German Federal Bank own more than a quarter of German government debt.

High-quality assets such as these are increasingly sought after as new capital and liquidity regulations make their presence felt, with the potential for costs to rise as supply dwindles. Some data is already showing rates triple those from a year ago. Adjustments to the programme, such as accepting cash collateral, are being made, but they may be too little to make a beneficial impact.

Alternatives may also be under pressure. In the US, investors are said to have moved $1 trillion from credit focused money market funds into government debt funds, further restricting access to high-quality bonds.

Nerin Demir
Head of repo and securities finance
SIX

The continuation of the asset purchase programme until December 2017 will further weaken the European repo market as the scarcity of good collateral will persist the longer the European Central Bank's asset purchase programme is extended at the same level as before. High-rated bonds will become more expensive and with increased failures to deliver, further pressure is expected in the European repo market.

A widening of the European Central Bank's collateral policy for securities lending may alleviate some of the pressures on the collateral side but those discussions are ongoing.

Furthermore, US dollar repo versus top-grade high-quality liquid assets may well see some upside with the recent upward interest rate movement in the US by 0.25 percent. This will create a positive effect with further rate rises expected in 2017.

Mick Chadwick
Head of securities finance
Aviva Investors

The market has become accustomed to negative repo rates. The revised terms of the European Central Bank's securities lending facilities, announced in December, should in theory be an aid to market liquidity, particularly the flexibility to use cash rather than securities as collateral.

Having said this, repo capacity for institutional clients is likely to remain constrained due to the continued pressure on bank balance sheets as a result of regulation. This will likely lead to greater buy-side engagement with alternative routes to market such as central counterparty models and peer-to-peer trading platforms.

Rob Kidman
Vice president, agency trading
State Street

The December announcement from the European Central Bank that quantitative easing would be extended at a lower level of €60 billion to the end of 2017 continues to weigh on the repo market, although some relief to German specials is expected. The European Central Bank also announced that central banks would be able to conduct securities lending versus cash collateral rather than general collateral. This is clearly aimed at alleviating the collateral shortage that has inhibited specials being borrowed from central banks.

Demand for German government bonds is expected to remain strong while some cheapening versus EONIA (Euro OverNight Index Average) is likely given the €50 billion limit on cash borrows set by the European Central Bank. Collateral shortages still remain, however, and the cost of short-dated repo for borrowers is also a hindrance for money market funds that still need to manage short-dated liquidity.

Regulatory requirements for the net stable funding ratio continue to see demand for longer termed repo, but to what extent the new measures will cheapen general collateral out to one year is unclear as other factors, such as balance sheet and the availability of high-quality liquid assets, are still likely to attract a term premium.

Michael Huertas
Associate and solicitor
Allen & Overy

As the asset purchase programme runs its course in 2017, we would imagine that the European Central Bank, and the relevant eurosystem national central banks, may make further amendments to the securities lending programme's rules to bolster actual and perceived liquidity in bond markets. This might also serve to further discourage any hoarding mentality that had crept into certain parts of eurozone bond markets as a result of perceptions of the asset purchase programme's distorting impact.

Going forward, the securities lending programme could continue to be tweaked on multiple fronts. In the short-term this might include changes to pricing and haircuts, which are relatively simple but nevertheless may still not be sufficient to fully dispel gripes that European Central Bank pricing is 'expensive'. Other more longer term changes, such as the European Central Bank and the national central banks accepting broader collateral (beyond what they already do in their other activity), or using a wider set of contractual documentation in securities lending programme activity, may take a longer time to implement.

Consequently, as the asset purchase programme continues to change, we might also see a rebalancing of national central bank-led, ie, decentralised, securities lending programme activity becoming more centrally coordinated by the European Central Bank. As currently one of the largest collateral takers and institutional investors, the European Central Bank is also likely to need to be receptive to solutions that have existed since the onset of the financial crisis to build sustainable collateral pools offering liquidity and transformation services to meet demands driven by regulatory and economic factors.

Given all that 2017 is likely to have in store, we would also imagine that there may be a higher degree of receptiveness to engage with concerns of the market. **SLT**

The first of its kind

Comyno is integrating distributed ledger technologies into its software to execute the first repo smart contract, as Markus Büttner explains

Why have you started looking into distributed ledger technologies?

At Comyno we are the only dedicated provider in the securities finance space offering full-scale services in consulting as well as our own software products. Since its inception, our consulting arm has been one of our key differentiators to drive innovation—both in business and technology.

We've kept our eyes on blockchain for many years since discussions started around bitcoin. But in contrast to the majority of fintech companies hyping bits of technology without proper use cases, we spent more time on listening to our clients and market participants, observing their real needs, attendance and abilities to adapt to certain innovations. In the course of 2016 we felt a change in our industry has taken place—with willingness to adopt new infrastructures solving legacy problems on the rise.

What progress have you made?

We connected our current flagship product C-One, which from the start had been designed as a distributed system, with different blockchain and distributed ledger projects in our testing labs and achieved great results.

More specifically, we have coded smart contracts for a variety of lifecycle events of repo transactions, resulting in trades on the distributed ledger prototype network. We opened a repo trade and transferred the corresponding cash versus a bond as collateral, doing a re-rate and winding up the transaction through another smart contract executing the close of the trade. All this resulted in the exchange of the cash, including interest, and the security back to the original owner.

Which technology did you use?

We conducted our testing on different platforms, including Ethereum and the recently open-sourced Corda, which had been developed by R3 and incorporates the input of more than 70 financial institutions worldwide. We were surprised to discover that our C-One software platform and Corda share the same underlying messaging technology, which made it a very straightforward exercise for us to translate Comyno C-One's securities finance transaction business logic into Corda contracts.

What are the possible applications for this type of technology?

Based on the positive prototype results in our labs, we've now started the development of a comprehensive solution in the area of direct central counterparty access. For the planned release of the middle of 2017, we envisage starting with a one-product concept with the possibility of ringfencing the digital world and utilising existing account structures and legal frameworks. More details will be shared in Q2 2017.

Look at the world as it stands at the moment—the technology itself and possibly the basic infrastructures will become freely available to anyone. As was observed in the business-to-customer space, apps and web services come firstly without cost, and it's those companies knowing how to 'play the consumer game' who figured out how to make users happy while at the same time making a profit.

Applying this to our business, it's the combination of our unique knowledge in both technology and the needs and obstacles of the broad network of different participants in securities finance markets that let us 'know the game'. We are using this to translate our visions into technological reality to foster market efficiency and the fulfillment of regulatory requirements at the same time. That's as detailed as it gets for now.

Will blockchain become the new normal for SFT business, or will it co-exist with current technology?

There are two ways of looking at it. We trust that our concepts are valid and our solutions will be adopted by the market. Naturally, from the start, we are just looking at small market fragments where we think we can add value without the rest of the world disrupting the technology and jumping on blockchain at the same time, which I doubt would happen anyway in its fullest scale.

I expect there to be a time of coexistence between the legacy world and blockchain/distributed ledger infrastructures. We have already shown that we are able to support the transition with our ready-for-blockchain software. As we are connecting legacy market infrastructures with C-One, we can act as the 'enabler' to move from the current to the future world, step by step. Investment in the current experiments will pay-off for Comyno and the wider markets. **SLT**

Markus Büttner
CEO
Comyno

It's simple to translate C-One's SFT business logic into smart contracts

Beyond tomorrow: What to expect in 2017

Pirum's Philip Morgan takes a look at the biggest events of 2016 and how they will affect securities finance in the year to come

As we head into another new year, it is commonplace to reflect on what has passed and, more importantly, consider what our resolutions will be for the coming year. As TS Eliot wrote: "For last year's words belong to last year's language. And next year's words await a new voice."

Last year will be remembered as the year of the unexpected, with the UK referendum on EU membership and the result of the US election stealing the headlines. The securities finance market paralleled this volatility with political and energy sector upheaval, leading to record revenues in North America and steady rises in Asian activity and revenues.

In Europe, the story was not nearly as positive, with the German market leading a Europe the Middle East and Africa (EMEA) revenue slump despite isolated positives, such as UK revenue rises. With further political uncertainty expected in 2017 in Germany, the Netherlands and especially France, it will be interesting to see if this trend continues.

Market instability has been reflected in participant activity, with a number of sell-side participants actively growing their global and product footprint following a period of financial resource optimisation and reduction. At the same time, we have seen a number of high-profile market participants significantly reduce or cease activities entirely.

On the buy side, despite an extended run of positive performance, hedge funds were beset by significant investor redemptions across the industry, seeing record outflows of $67 billion through the first three quarters of 2016. On a more positive note, the alternative space did grow by approximately 3 percent overall and finish the year in excess of $3 trillion assets under management.

Against this backdrop of opacity, there are a few common and consistent messages emanating from the market. There is a demand for greater connectivity, agility, digitisation and operational efficiency.

In 2017, the level of uncertainty remains high and only adds to the daunting prospect of complying with a seemingly unceasing barrage of compliance and regulatory demands, let alone the effort required to drive revenue in a period of market turbulence.

Increasingly, institutions seem to be making a distinction between commoditised functions that could be outsourced versus areas where they can deliver competitive advantage to their customers. "Compete in the front end and collaborate in the back end" is increasingly being used as a tagline for managing this non-differentiating technology.

In managing their burden, firms are increasingly looking for solutions to help them meet and manage their reporting requirements under regulatory regimes such as the Markets in Financial Instruments Directive (MiFID), money market statistical reporting, and the Securities Financing Transaction Regulation (SFTR). Where there is no revenue opportunity or competitive advantage, centralised regulatory technology (regtech) solutions are being considered to socialise cost and transform it into a variable line.

The complexity and frequency of regulatory reporting requirements to meet MiFID, SFTR and liquidity standards continues to stoke demand for robust and interoperable data solutions.

The drive for automation and digitisation has increased the importance of technology solutions. Last year, we saw a steady flow of sell-side figures transferring to technology roles to assist in system design and product development, and this is likely to continue in 2017.

As well as regulation, efforts are centring around the creation of greater efficiency in operating models, to enable focus on outperformance and growth. Many sub-optimal processes remain in the securities finance industry with significant opportunities for improvement and automation through collaboration.

Increasingly, business owners are realising that, given challenged revenues, cost is a variable that in many ways is more controllable and under their direct influence.

One fascinating area of development in securities finance is where trading is taking place and how institutions are connecting to these new venues. We have heard much about the transition of business to a central counterparty and its potential as a panacea to all. While the benefits are being debated and analysed, Pirum is seeing a continued migration of business to this capital efficient clearing vehicle, which is likely to continue in the coming year.

The development of so-called ‘all-to-all’ trading via multilateral trading facility platforms that offer to unlock ‘golden sources’ of high-quality liquid assets to the market will be an interesting 2017 trend. The move away from over-the-counter/voice execution towards an electronic disintermediation model seems to be gaining favour, however, when and where this liquidity will go remains to be seen. So the need for robust and agile connectivity will remain a crucial requirement.

The requirement to build brings its own complexities and comes at a time when the demands on a finite technology resource have never been greater. When you consider the multitude of connectivity variables in the market, unless you have an agile solution, the importance of placing your bet at the correct table is critical.

In the coming year, we are likely to see a continued blurring of lines between the front, middle and back office where operational complexity coupled with financial resource consumption increasingly defines the medium of execution. This hybrid of technology-led market evolution has been described as ‘the rise of the coder’, with front-office traders and sales teams being enhanced and in some cases substituted by coders and other technologists.

But fear not, it is not all negative in 2017

We are likely to feel a few tailwinds improve market conditions. The recent rate increase in the US has finally seen a move away from low rates that will hopefully translate into a period of upward fee trajectory across the full range of the securities finance market. While this positivity is only seen in the US currently, it is hoped that European and Japanese rates may lift from their current levels in time. In addition, we should not forget that important fundamentals such as GDP continue on a positive trajectory in the US and the EMEA.

Potential regulatory changes around non-cash collateral in the US could potentially provide an uplift to the market and reduce overall costs for borrowing securities, albeit with some market infrastructure challenges to get businesses ready for this non-delivery-versus-payment environment.

Critically, if we turn the clock back 12 months to January 2016, when analysts told us to sell everything except high-quality bonds, because it’s about return of capital, not return on capital, take into account the tumultuous events of 2016. It is interesting and encouraging to note where markets have ended the year, with many major indices closing in on all-time highs and a potential post-Donald Trump inauguration boost expected.

Furthermore, it seems increasingly likely that key regulations may see delays and in some cases repeal in the coming period, which would offer the market a chance to catch its collective breath.

As we start to ‘think beyond tomorrow’, it has never been more important to have a clear strategy and, of course, the resources to enable its execution. In this regard, Pirum will continue in its commitment to the market to improve connectivity, automation and strive to make the complex simple.

Therefore, we do consider there to be more than a few reasons to be cheerful. While 2016 will go down as the year of the unexpected, we hope 2017 will be remembered as the year of collaboration. Happy New Year from Pirum. **SLT**

Key regulations may see delays and in some cases repeal

Phil Morgan
Head of business development
Pirum Systems

Blessed are the retailers

After a tough year on the high street, many UK retailers were pinning their hopes on a good Christmas. David Lewis of FIS Astec Analytics reports

It is said that the Christmas season is the time for giving and this, of course, means it is the season for buying things to give. Many retailers count on this period to top up their sales targets for the year, and some pin much of their annual performance on the success of their Christmas period. After a tough year on the high street, many UK retailers were pinning significant hopes on a good Christmas, looking to grab as much of the goodwill being spent by consumers as they could.

While much is made of data on footfall and high street retail performance, it is no longer just about what happens on the street in the bricks and mortar shops, but so much relies on what happens on the internet, with this now fixed as a key battleground for many. Certainly one name that cropped up throughout 2016 in relation to online presence, or the previous lack of it, was WM Morrison supermarkets. Lagging behind the competition on the delivery of internet groceries, Morrisons, as the supermarket is known on the high street, leapfrogged the rest with the launch of its 'Fresh' delivery service partnership with Amazon, while at the same time pulling the proverbial rug out from under its other provider, Ocado.

At the end of 2016, WM Morrison has the unenviable position of being the second most shorted UK share on the London Stock Exchange, with a disclosed 17 percent of its share capital as reported under the Financial Conduct Authority (FCA) rules. However, can this statistic be taken as a reliable indicator on its own? Should we all be selling WM Morrison and jumping on the short bandwagon, or is it second on a list of not very short shorts?

Over the past 12 months, short interest in WM Morrison has decreased significantly. By volume, short interest is down some 35 percent, (see Figure 1) but compared with supply, the level of short interest activity has reduced by 44 percent, suggesting that supply has increased as larger institutional funds have bought into the WM Morrison turnaround plan under the chief executive, David Potts. Such investors were no doubt attracted by the 50 percent gains made by WM Morrison shares over the last 12 months, helping drive down the levels of short exposure held by some funds. FIS Astec Analytics data shows significant short interest remains, however, arguably reinforcing the disclosed positions revealed by the FCA, data that is rather sporadic by its nature given the relatively high thresholds of 0.5 percent of issued share capital. The remaining short sellers may, of course, be expecting some of the 50 percent share gain to be reversed if WM Morrison doesn't deliver as many are expecting. With 45 percent of the available shares being borrowed, the level of short interest activity cannot be dismissed, and even after the gains made in 2016, the shares remain some 25 percent below the five-year peak hit back in February 2012.

The next few weeks will bring a flurry of reporting activity, but many investors are looking further forward rather than looking for validation of what has passed. For 2017, there is much talk of increasing inflation, higher prices in the shops especially regarding imported goods due partly, at least, to the falling British pound following the Brexit vote, combining to squeeze consumer spending. Early skirmishes have already been played out very publicly, such as that between Tesco and Unilever, the maker of Marmite, as producers and retailers attempt to exercise pricing power to protect their own margins. With frenzied levels of competition, retailers will find it hard to pass increased costs to their customers, which can only result in squeezed margins for the retailers or their suppliers.

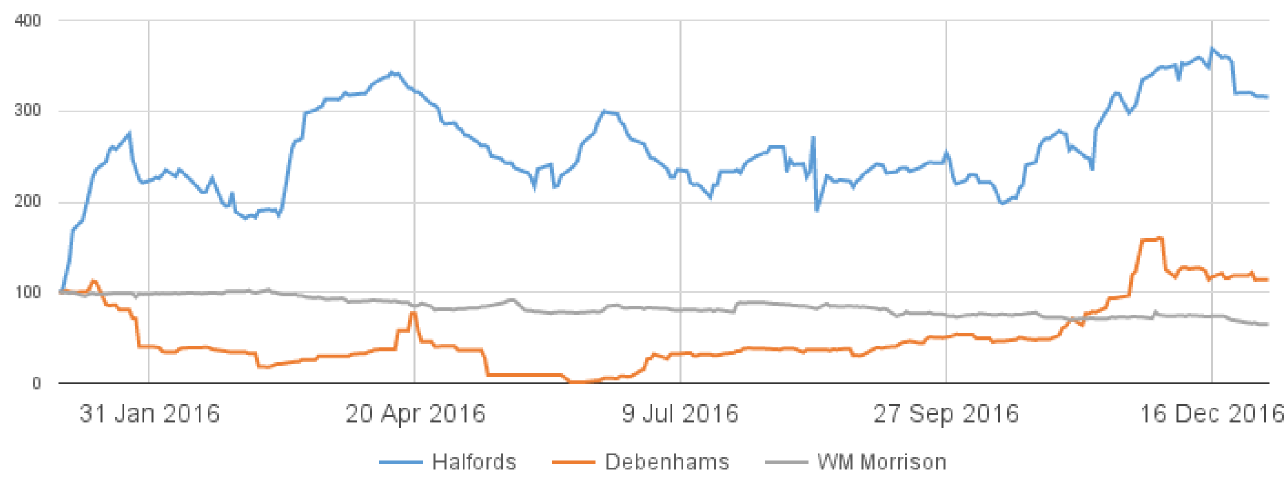
Short sellers are targeting other mainstream retail names such as Halfords and Debenhams. Both these names saw increased short selling activity in the build up to Christmas, with Debenhams seeing a 12-month high at the start of December, although this has fallen back by around one-third by the start of January. During December, the share price changed very little, suggesting that a resistance level of sorts may have been reached and the short sellers closed out their positions, having gained significantly from the 30 percent share price drop seen since April. Like WM Morrison, however, the remaining levels of short interest are certainly elevated compared with the rest of 2016.

Halfords saw a similar bounce pre-Christmas, with short interest recording a new 12-month high around a week before the big day, before dropping by 14 percent by the New Year. Some of this change may have been due to profit taking, as the shares fell around £0.15 over the same period, but going into 2017, short interest levels remain below previous peaks seen in 2016 and around 22 percent over the average for the prior 12 months.

This would suggest that, despite Halfords already falling by more than £1 from the previous 2016 highs of £4.40 a share, there may be more losses to come in 2017.

With significant political and economic change across Europe expected in 2017, there is much talk of uncertainty and fear, whether it be about job security, squeezed consumer spending or rising inflation and a falling pound. Looking at this sample of retail shares doesn't give a clear message of what to expect, but that is potentially an indicator itself, such that 2017 will bring gains as well as losses. It just depends on who you are. **SLT**

Figure 1: Short interest levels for WM Morrison, Halfords and Debenhams, indexed to 4 January 2016



The remaining levels of short interest are certainly elevated

David Lewis
Senior vice president
FIS Astec Analytics

Industry **Events**

February 2017

31-02

IMN's 23rd Annual Beneficial Owners' International Securities Finance & Collateral Management

Florida

As we head into 2017, it's not business as usual within the securities finance industry. As new opportunities—and challenges—come to the forefront in this dynamically evolving market that may have a direct impact on securities finance.

March 2017

7-9

14th Annual PASLA RMA Conference on Asian Securities Lending

Seoul

14th Annual PASLA and RMA will be held in Seoul, South Korea, at The Conrad Seoul.

April 2017

2-3

Finadium Investors in Securities Lending Conference NY 2017

New York

Leading industry participants have joined together to give institutional investors a fresh look on securities finance in a changing regulatory environment.

April 2017

26-27

Finadium Investors in Securities Lending Conference London 2017

London

Leading industry participants have joined together to give institutional investors a fresh look on securities finance in a changing regulatory environment.

May 2017

15-17

European Pensions & Investments Summit 2017

Switzerland

The 17th annual European Pensions & Investments Summit is the ultimate meeting point, bringing elite buyers and sellers together.

Comings and goings at BNP Paribas, Triad Securities, FINRA and more

BNP Paribas has appointed Lutz Diederichs to take over the role of group head of Germany and chairman of the group management board in the country.

Diederichs joined BNP Paribas on 1 January, and will fully take on his new responsibilities in March, following a transition period.

He will take over from Camille Fohl, who is relocating to Paris to take up a role as adviser to the BNP Paribas Group executive committee.

According to BNP Paribas, the change is part of a wider growth plan for Germany, and Diederichs will be advising on business development within the group.

Diederichs joins from HypoVereinsbank, where he spent 25 years in positions including head of the corporate division for Bayerische HypoVereinsbank and senior director for large corporates and real estate financing.

Since 2009, he has been a member of the board of HypoVereinsbank-UniCredit Munich.

In his new role, Diederichs will report to Philippe Bordenave, COO of BNP Paribas and the group executive committee member responsible for business in Germany.

Deutsche Börse has appointed two new senior product development personnel for its Eurex derivatives segment.

Lee Bartholomew has taken on the role of head of Eurex's derivatives product and research and development (R&D) for fixed income, while Zubin Ramdarshan is now head of derivatives product and R&D for equity and index.

Bartholomew moves to Deutsche Börse from Royal Bank of Canada (RBC), where he was responsible for developing the bank's flow structured rates business. Prior to RBC, he held senior trading positions in structured rates at Lloyds Banking Group.

Ramdarshan joins from financial services firm Cantor Fitzgerald where he was a managing director for the European exchange-traded funds business. He also served in senior roles at Jefferies, Macquarie Bank and Bear Stearns.

US broker-dealer Triad Securities has brought on Tom Landsbergen as director of prime brokerage sales.

Previously, Landsbergen was responsible for prime brokerage sales and client service at J.P. Morgan and Bear Stearns in New England and Canada.

He also served in a number of positions with the prime brokerage platforms of Furman Selz/ING Barings. Landsbergen will continue to be based in Boston.

Bradley Bennett is to leave his position as chief of enforcement at the Financial Industry Regulatory Authority (FINRA).

Having held the position for almost six years, Bennett is returning to private practice.

Susan Schroeder, deputy head of enforcement, has been appointed as acting head while FINRA searches for a replacement.

Bennett joined FINRA in January 2011, as executive vice president and chief of enforcement.

He oversaw 300 enforcement staff in 14 district offices throughout the US. Before this, he worked at Baker Botts, specialising in financial and securities law violations.

Under Bennett's leadership, FINRA's enforcement division took action on preventing fraudulent conduct, including use of temporary cease and desist orders. **SLT**

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