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SECURITIESLENDINGTIMES

ISSUE089
12.11.2013 TUESDAY
securitieslendingtimes.com

BNY Mellon settles with Florida for $28 million but admits no guilt

BNY Mellon will pay $28 million to the State of Florida to settle allegations of overcharging for foreign currency transactions and cash reinvestment losses.

The bank admitted no wrongdoing in agreeing the 31 October settlement to end the litigation between the State Board of Administration, which runs the Florida Retirement System Trust Fund, but state attorney general Pam Bondi called it a "substantial recovery on behalf of [the state's] retirement fund".

The settlement provides full compensation for Florida's past foreign currency trades and ensures complete transparency on the pricing of future trades, according to the attorney general.

It also compensates the State Board of Administration for investments made through BNY Mellon's securities lending programme, on behalf of the state, in medium-terms notes issued by Sigma Finance, which defaulted on certain notes in September 2008 before going into receivership.

"We worked hard to achieve this substantial recovery on behalf of Florida's retirement fund," said Bondi in a statement.

BNY Mellon became the State Board of Administration's custodian in July 2005, signing a securities lending agreement at the same time.

A whistleblower originally brought the case against BNY Mellon, but the State of Florida joined in 2011.

A BNY Mellon spokesperson said: "We are gratified that the Florida attorney general is withdrawing her lawsuit and that we have resolved issues related to the State Board of Administration's securities lending programme. We're also pleased to reach an agreement with the State Board of Administration that allows us to continue our longstanding relationship."

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Pershing adds link to securities lending programme

BNY Mellon company Pershing has created a "seamless" link between its PrimeConnect application and its Fully Paid Securities Lending programme.

The new connection to Pershing's Fully Paid Securities Lending programme allows hedge funds, through an automated solution, to transfer fully paid securities from BNY Mellon to Pershing.

Pershing will in turn be able to borrow those shares, while hedge fund managers will be able to see the earning potential of fully paid assets in the prime services dashboard on NetX360, Pershing's technology platform.

readmore p2

Strate and Clearstream to tackle collateral

The South African central securities depository, Strate, and Clearstream have jointly launched a centralised collateral management service for the South African financial market.

A release from both firms stated that some of South Africa's largest financial institutions, including banks, a number of fund managers and the Johannesburg Stock Exchange (JSE), have already committed to exploring the use of these services.

The statement explained the reasoning behind the launch as regulatory-focused, due to future rulings such as Basel III and Solvency II placing pressure on the availability and funding costs associated with holding high-quality liquid assets.

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BNY Mellon settles with Florida for $28 million

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"We have always viewed these issues as commercial matters and have taken a pragmatic approach to resolving them directly with our clients."

Sigma Finance's legacy has already cost BNY Mellon millions of dollars.

In its Q2 2012 results, the bank said it had put aside up to $280 million to settle in part a complaint from workers' compensation insurance company CompSource Oklahoma.

It filed the complaint over losses connected with the investment of securities lending collateral in Sigma Finance.

Outside of the US, the Commercial Court in London recently awarded undisclosed damages to Swedish fund Första AP-fonden (AP1).

The action was lodged by the fund in response to losses incurred as a result of securities lending transactions handled by BNY Mellon.

The court ruled in favour of AP1's claim on several points, with the judge noting in the ruling that BNY Mellon has failed in its care when handling the fund's mandate.

The ruling stated that BNY Mellon had been "negligent" with AP1's securities lending programme, leaving the bank liable for the damages incurred.

The damages will cover of the fund's losses, as well as expenses accrued in lost interest. BNY Mellon will also cover most the AP1's legal costs.

Johan Magnusson, managing director of AP1, said: "It is very satisfying that the Commercial Court in London has found in our favour. The judge stated that BNY Mellon has been guilty of many violations and that Första AP-fonden has acted correctly."

A spokesperson for BNY Mellon said: "The London court found that there was no deliberate attempt by BNY Mellon to mislead and found that we acted properly, both in purchasing Sigma and in adopting a hold-to-maturity strategy. We disagree with the portion of the judgement that ruled against us and are considering our options."

Pershing adds link to securities lending programme

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Brian Ruane, CEO of broker-dealer services at BNY Mellon, said: "Pershing's PrimeConnect is just one example of how BNY Mellon is leading the way in helping clients to source and optimise collateral, enhance the velocity and mobility of that collateral, and to address their wider requirements around liquidity, financing and reporting."

Strate and Clearstream to tackle collateral

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"In addition, the G-20 finance ministers have also recommended that all standardised OTC derivatives should be cleared with central counterparties (CCPs)."

"The cumulative effect of each of these changes, the need for greater transparency as well as the specific South African regulatory and legislative obligations stated in the Financial Markets Act and Regulation 28 of the Pension Funds Act, point to a re-think of collateralisation in the industry."

Strate's strategic projects director, Anthony van Eden, explained that there has been an overwhelming interest from the local market for the use of the service.

"We are also in discussion with a number of other financial institutions, in addition to the ones named above, who are seeing the benefit of this industry-wide initiative and exploring the use of the service."

SLTINBRIEF

Stefan Lepp, head of global securities financing at Clearstream, said: “We are delighted that we have partnered with Strate in South Africa to assist financial institutions in managing their domestic collateral more efficiently.”

As part of its risk and liquidity management offering, Clearstream has developed a collateral management outsourcing solution allowing its market infrastructure partners such as Strate to manage the collateral of their underlying client base.

The assets never leave the domestic environment and remain under local jurisdiction. Contractual agreements between the partner, Strate, and its domestic client base remain unchanged. The initiative has gained momentum, as upcoming regulatory changes require financial and non-financial institutions to improve their capital management.

Anetics adds new capabilities to Twill platform

Anetics has updated its Twill platform with new functionality that allows the listing of securities for borrow and loan.

Anetics develops and implements securities lending technology platforms, reducing the infrastructure investment of its clients. Its platforms are available white-labelled so as to allow the user to maintain consistency in tool kit branding.

Following the update, a user may make bids and offers in any screen in real time, which will raise an alert on the counterparty’s desktop when a new order is pending. This streamlines workflow between counterparties.

Anetics business analyst Chelsea Potvin said: “This is particularly useful for lenders in possession of warm or hot stocks that don’t have time to be on the phone with many different counterparties, yet wish to engage with multiple borrowers concurrently.”

Rob Sammons, CEO at Anetics, added: “We’ve been experimenting with different methods for dealers to interact for many years. Early on our efforts were met with resistance to such new

methods. However, times have changed and this latest enhancement makes it easier than ever.”

Wolters Kluwer looks for easy lending ride

Wolters Kluwer Financial Services has put in place automated securities lending functionality for its GainsKeeper FundTax REIT solution.

The enhanced module aims to ease the burden of manually tracking securities lending for real estate investment trusts and its effect on tax re-allocations, and hopes to save time and reduce the risk of reporting errors.

The REIT module of the FundTax reporting solution automates the calculation of tax reallocations and relevant basis adjustments on sold securities.

The new functionality injects securities lending data into existing reports. It has the ability to translate CUSIP level data into lot level data, resulting in a tax accurate application of shares on loan to specific lots, said a statement, adding that the system features a detailed audit trail for ease of review.

“By automating this process for our clients, mutual fund tax accountants can significantly reduce the risks of inaccurate reporting and associated IRS penalties,” said Chuck Ross, general manager of investment compliance solutions for Wolters Kluwer Financial Services.

“This greatly enhances their ability to address multiple business and regulatory rules efficiently and meet applicable requirements accurately and on time.”

US triparty repo collateral drops $68 billion

The New York Federal Reserve has released its monthly triparty repo data for the US for September, revealing a decrease among most asset classes.

As of 9 September, total collateral in the US triparty repo market decreased by $68 billion, a decrease of 0.4 percent.

“The amount of collateral decreased for almost every asset class, with corporates non investment grade leading the decrease by $1.5 billion, or 8.6 percent,” said Todd Zerega and Cátia Kossovsky from the law firm Reed Smith.

“Haircuts remained relatively stable, with the median haircut remaining constant for all collateral types in September.”

easyJet completes first triparty trade

A partnership between Clearstream and 360T to develop a new triparty repo service has seen its first trade completed.

Corporate and institutional clients were the main target for the new service developed at the start of 2013 by Clearstream’s global securities financing team and 360T Trading Networks, an electronic trading platform.

It incorporated a streamlined triparty repo solution that was to be delivered through 360T’s front office facilities and integrated with Clearstream’s global liquidity hub.

360T would then offer the service to matched trading partners, which are members of its client database. These trading counterparties will have signed Clearstream’s collateral management service agreement (CMSA) so that Clearstream can take care of all the administration of the triparty repo transaction.

This cooperation extends the Clearstream service to non-financials.

The process was designed to be as easy and as secure as possible, with the cash provider being able to choose from a range of standardised baskets or create their own collateral schedules.

On 17 October, the first triparty trade was conducted on the trading platform of 360 Treasury Systems AG and settled via Clearstream.

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Securities Lending: 2014 Outlook

SLT and Citi invite beneficial owners and consultants to a breakfast seminar on 21 November 2013 looking at navigating securities lending in exceptional times

8.00am – 8.30am	Registration and networking breakfast
8.30am – 8.35am	Welcome address: Justin Lawson, Publisher, Securities Lending Times
8.35am – 9.00am	Introduction and market summary: David Lewis, Senior Vice President, Astec Analytics, SunGard's capital markets business
9.00am – 10.00am	2014 Outlook: panel discussion The panel will cover areas of interest for the beneficial owner, from regulation to trading, product development to hedge funds, and more. The panel will be moderated by Gavin Callan, Director, Securities Finance, Citi. He will be joined by: Kevin McNulty, CEO, ISLA David Martocci, Global Head of Securities Finance, Citi David Brand, Head of Short Term Product Sales, Europe, Morgan Stanley Roger Fishwick, Chief Risk Officer, Thomas Murray Additional panellists should be confirmed in the coming weeks.
10.00am – 10.30am	Coffee and networking

Venue: Citi offices, Stirling Square, 5-7 Carlton Gardens, London, SW1Y 5AD, UK

For more information on the event contact justinlawson@securitieslendingtimes.com

Alternatively, register your interest at www.securitieslendingtimes.com

The trade involved easyJet, which was the cash giver, and Commerzbank, the cash taker.

Philip Stewart, assistant treasurer of easyJet, said: "easyJet adopts a prudent investment policy, with security of cash the number one priority. This, in addition to the ability to increase tenor and maximise return on our core cash, was a key factor when exploring alternatives to time deposits and money market funds."

"We took the decision to begin using triparty repo due to the liquidity of the repo market and the fact that collateralised deposits are more secure, while also benefiting from the higher yields on offer for longer dated deposit terms."

He added that Clearstream was chosen due to its desire to provide a service specifically tailored to corporates.

Carlo Kölzer, 360T's CEO and founder, said that the service opens a new area of trading in cash management and that he expects this to become a market standard soon.

"Collateral management is gaining in importance in the market and with Clearstream as a partner we can offer our clients a proven concept. Furthermore, the case shows that when best of breed service providers work together, they are able to create highly valuable value chains for the customer as proven by Commerzbank, Clearstream and 360T in this case."

The partnership between Clearstream and 360T is part of a series of recent developments designed to facilitate easy and streamlined access to triparty repo.

Earlier this year, Clearstream developed a new legal master agreement for triparty repo transactions, Clearstream Repurchase Conditions, to enable market participants to sign just one contract for multiple counterparties and speed up counterparty 'marriage broking'.

The repurchase conditions, said Clearstream, are proving to be of particular interest to new players in the repo market, such as corporates that are currently deterred by the existing lengthy contract negotiation process.

They are expected to appeal to corporates entering into reverse repos to secure their financing and then, optionally, re-use the collateral they receive to cover OTC derivative margin requirements with clearing members or central counterparties.

Maxim chooses SunGard for prime brokerage accounting

Maxim Group, an investment banking and brokerage firm, has selected SunGard's VPM to provide portfolio accounting and reporting capabilities to help it to improve its client service.

Maxim Group's integration of the platform has been designed to deliver minimal reconciliation overheads. VPM physically stores all of Maxim's investment activity to improve data accuracy.

Seth Michaels, head of prime brokerage services at Maxim Group, said: "As our investor requirements continue to call for increased transparency and reporting for hedge fund portfolio accounting, our need grew for a powerful, user-friendly product with a highly scalable infrastructure."

The implementation of SunGard's VPM was completed in three months. Maxim Group has been a SunGard customer for 11 years. It currently uses the technology company's Global Network and Valdi pre-trade compliance system.

Scott Alintoff, chief operating officer of SunGard's asset management business, said: "This implementation is significant and is a testament to the prime brokerage industry's need for transparency and automation."

Gunmaker shoots to the top

DataLend has released its securities lending top 10 earning equities for 24 October, revealing that Sturm Ruger has shot to the top of the US chart.

DataLend's lists rank the securities lending top 10 earning equities in each of the US, UK, Europe and Asia Pacific, along with some context around the top few in each region.

The report showed that fees to borrow Sturm, Ruger & Co, a firearm manufacturer, continued their downward slide as the stock price climbed higher.

Utilisation, which had been level at around 96 percent in recent weeks, rose higher.

Sears Holdings fees to borrow have been fairly level in hot territory in October, said DataLend. The stock price has come back down from a peak in early October, and utilisation remains high but down since September.

3D Systems fees to borrow were rising but have dropped again—though they are still hot. The stock price has been inching up since a spring dip reversed.

UK

In the UK, fees to borrow Kazakhmys, a copper mining company, are now riding the line between warm and hot since rising from general collateral levels in late June. Utilisation has risen from the single digits in January to more than 90 percent recently.

Hanergy Solar fees to borrow have risen steeply since early October, while the stock price and utilisation have remained relatively stable over the last few months.

Fees to borrow Gulf Keystone Petroleum stock have come down significantly recently, and utilisation has dropped a touch. The stock price peaked in the middle of September, but dropped again in October.

Europe

Utilisation of Outotec dropped almost 10 percent over a month, and the stock price has dipped too. Fees to borrow remain hot.

The stock price of Halcon Resources has shown improvement throughout October after sliding for most of 2013. Days to cover remain high at more than 60, while fees to borrow are hot but down on early-October rates.

Utilisation of Banca Monte dei Paschi di Siena has dropped nearly 20 percent in the last two months, but fees to borrow have quadrupled the rate at which they started 2013.

Far East/Australia Pacific

GungHo Online Entertainment fees are climbing even higher. The stock price has rebounded slightly since the last-August dip, while utilisation has remained in the mid-90 percent range for months. GungHo isn't showing signs that it will be dropping off the list anytime soon.

Celltrion stock has dropped in price over the past two months. Fees to borrow have risen slightly over that period, but have been wavering between general collateral and hot recently.

BYD Company H fees to borrow are now about half where they started the year, while the stock price continues its ascent. Utilisation peaked in August, came down in September, and rose again in October.

BNY Mellon stocks up collateral arsenal

BNY Mellon has added a liquidity aggregation service to its suite of risk and collateral management-related services.

"As markets expand globally, the need to analyse and quantify your portfolio return and liquidity risk is paramount," said Kurt Woetzel, CEO of BNY Mellon's global collateral services (GCS) business.

"The liquidity aggregator offers clients a deeper view of exposure and risk, which is essential to managing their investments."

"Nearly all financial transactions and commitments have liquidity implications," said Jonathan Spirgel, executive vice president and head of GCS sales and relationship management at BNY Mellon.

"To be highly effective, liquidity risk management requires insights, tools, products and services that support a client's ability to both maximise liquidity and analyse investment exposure."

The liquidity aggregator, a companion to BNY Mellon's liquidity DIRECT(SM) solution, was created to help clients gain a new level of insight into their investments, across all US and non-US domiciled funds in their portfolios.

The system is designed to help clients actively monitor and help to control liquidity risk exposures and manage funding needs, taking into account security types; country and region of exposure; country and region of risk; and weighted average yields and maturities.

Clients can leverage the new dashboard across their entire investment portfolio to view: exposure across all funds with positions; money market mutual fund full holdings in a single place; largest holdings in the portfolio by security type and issuer across multiple funds, with the ability to determine shared securities; and trends and reporting for month-end and at six-month intervals for money market mutual funds daily yields, WAM and holdings.

OneChicago's total equity volume booms

Trading volume at the equity finance exchange OneChicago increased 76 percent last month over October 2012, as a result of managed futures traders diversifying their holdings using single stock futures.

OneChicago's October 2013 volume was 747,797.

Open interest stood at 618,050 contracts on the equity finance exchange on 31 October, up 27 percent year-over-year.

Some 728,266 exchange futures for physicals and blocks were traded. In September, they represented $ 3.7 billion in notional value.

OneChicago's also revealed that 53 percent of October 2013 month-end open interest was in OCX.NoDivRisk products.

"With the impending capital constraints caused by Basel III, we are seeing evidence of funds being squeezed by their prime brokers. These participants are beginning to understand how to utilise our products as a form of synthetic prime brokerage, giving them access to leverage and financing," said David Downey, CEO of OneChicago.

OCC enjoys new loans in October

OCC's securities lending central counterparty activities saw a 26 percent increase in new loans from October 2012, with 97,472 transactions last month.

Year-to-date stock loan activity is up 28 percent from 2012 with 1,054,624 new loan transactions in 2013. The average daily loan value at OCC in October was $70,720,228,408, marking the highest average notional value to date.

OCC also cleared 5,494,255 futures contracts in October, a 69 percent increase from the same month in 2012.

Its average daily cleared futures volume is up 66 percent from 2012 with 237,516 contracts. OCC's year-to-date total cleared futures volume is up 67 percent from 2012 with 50,115,859 contracts.

The equity derivatives clearing organisation's cleared contract volume in October reached 407,220,455 contracts, representing a 24 percent increase from the October 2012 volume of 327,576,945 contracts.

It marks the first time since August 2011 that cleared contract volume hit 400 million contracts in a single month and the fourth time in its history.

OCC's year-to-date total cleared contract volume is up 4 percent from 2012 with 3,526,716,786 contracts.

Eurex Repo experiences voulme dip

Eurex Repo reported for all of its markets an average outstanding volume of €210.3 billion last month.

It recorded an average outstanding volume of €235.2 billion in the same month in 2012.

The secured money market GC Pooling recorded an average outstanding volume of €144 billion compared to €162.9 billion in October 2012, the Euro Repo Market reached an average outstanding volume of €37.8 billion, an increase of 9 percent year-on-year.

The Swiss Franc Repo market reached €28.5 billion.

The international derivatives markets of Eurex Group recorded an average daily volume of 7.9 million contracts in October.

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Fixing it up

Otkritie Securities's head of repo, Andrew Gazzard, tells SLT how the Russian firm is working on expanding its fixed income offering

GEORGINA LAVERS REPORTS

Could you summarise the securities lending division of Otkritie Securities?

There are two sides to our business. We have staff in London that primarily deal with the international business and the international counterparties, and then we have a similar team in Moscow, who deal with our Russian clients, or domestic business.

I would liken our London team to the funding tool, whereas our Russian team are more client-facing. As we are part of a Russian bank, a lot of our client flow comes out of Russia, such as corporates and various other banks that we deal with in Moscow. We can use that from a London position to funnel ourselves into the international market.

We operate in London so that we can be FCA-regulated and UK-licensed—and these facts mean that we are treated very differently than a Russian entity might be.

We are very active in fixed income and also in Russian ADR/GDR financing. We also have some US equities and European equities, so it's quite a mixed bag. As a bank, we've always been predominantly known as an equity house but we are expanding our fixed income business currently. We are in the top couple of direct market access (DMA) providers to the Russian markets, and then obviously we have equity sales trading in London.

How long have you been actively pushing the fixed income side of the business?

We started it quite a few years ago and after a two-year hiatus, we are now starting to expand the business again.

We went back to our core products, stabilised everything, and moved forward again.

The Sberbank and Troika merger (completed in January 2012) resulted in our adding a few new staff, and currently we have a team in Moscow of over 10 traders. This is a lot more than there were originally, and Konstantin Tserazov, the head of FICC, is leading the development and expansion.

More recently, Otkritie Financial Corporation took over Nomos Bank (completed in July 2013), one of Russia's most profitable and rapidly growing privately-owned banks.

Nomos were predominantly known as a fixed income house too, so we have a great deal more talent in that designation. It has pushed the product suite of fixed income instruments along quite nicely, and has also given us access into a lot of further corporate clients in Moscow that we didn't have access to before.

What was your experience prior to Otkritie?

I started off working in various back offices, and resulted in my first role at Swiss Bank. I then got involved in securities lending and gilt repo, and then from gilt repo into an agency lending set-up, and then into emerging markets. I've been based in emerging markets ever since.

I have been around long enough to see the effects of various defaults over the years. The first that I saw was when I was working at Swiss Bank (now UBS), when Russia defaulted in 1998. It was horrific. One day you were dealing with a bank, and then you would ring that bank and no-one was there.

It took many weeks to resolve. From there I moved to Standard Bank in London, which at the time was a very minor subsidiary of a very big South African bank. Emerging markets were their business.

I was also around for the Argentina default, in 2001. I was in Argentina 3 months prior to the default, meeting all of the banks—and you could see the negativity of the locals. Typically they are very bullish about the currency and the country, but when even they were saying that the situation wouldn't end well, we went back and put on specific trades to tailor for that outcome. It worked out well for us, and was a very profitable year.

I was at Depfa Bank when the Lehman Brothers default happened. This brought about many issues regarding our liquidity and that of many other banks and financial institutions, which eventually led to the nationalisation of Depfa. From there, I came to Otkritie Securities.

How do you see Otkritie as being unique in this marketplace?

There are obviously a great deal of Russian banks, but after our merger with Nomos, we have elevated ourselves to being the second largest privately-owned bank in Russia (behind Alfa-Bank).

However, Alfa-Bank still has one majority shareholder, whereas we don't have any major shareholders that own more than 25 percent of the firm. We are more independent-looking for a privately-owned bank. We're also still small and agile enough to get things done—I can get access into senior management very quickly to get approvals for things, and this has been key in some of the trades that we've done—and I also feel that relationships are a major part of our business.

We are very keen on building a lot of contacts across many different banks and working together to do as much business as we can.

> "I am very confident that Otkritie will continue to grow and develop into one of the largest financial institutions in Russia"

Ultimately, we have a very good core client business in Russia that is constantly expanding, though it is tougher in Russia because the state-owned banks will always get a certain amount of business.

We have expanded trade-wise and book-wise this year quite significantly, and I hope for us to do similarly well next year, depending on the market. I am very confident that Otkritie will continue to grow and develop into one of the largest financial institutions in Russia. **SLT**

The final countdown

Elspeth Goodchild of Rule Financial explains how institutions can gain support from triparty structures in the countdown to compliance

The final countdown to compliance is well and truly underway, as was demonstrated by the recent authorisation of the first trade repositories under the European Market Infrastructure Regulation (EMIR) by the European Securities and Markets Authority (ESMA).

Following years of drafting and consultation with industry participants, we are now beginning to witness the implementation of new regulations governing OTC derivatives trading on both sides of the Atlantic.

The US Dodd-Frank Act and EMIR impact every element of the derivative trade lifecycle, and firms should have already invested heavily in robust compliance initiatives if they are to ensure that they will be fully compliant within the appropriate timeframes.

However, a combination of the need to reduce operating costs and a lack of involvement in the drafting process has left the buyside struggling to adapt and comply. This is in sharp contrast to their sell-side counterparts, who have been bracing themselves for incoming regulations for some time.

Both Dodd-Frank and EMIR influence execution, confirmation, clearing, margining, and reporting, but there are many differences in their exact scope and requirements. Extraterritorial issues between regulations further complicate the compliance landscape. Institutions will need to ensure they are fully aware of jurisdictional regulations and that they capitalise on any opportunities for interoperability.

There is also Basel III to consider, which measures overall risk exposures more stringently, and forces banks to set aside additional risk-free capital in their reserves. This will impact sellside institutions, their business model, and the choice of which asset classes they participate in—all of which could have a significant impact on the buyside, requiring them to open new relationships in order to access markets.

Other concerns plaguing the buy side include:

- New trade reporting responsibilities: it cannot be assumed that sell-side firms will perform trade reporting, and buy-side firms must keep sight of the fact that they are still legally responsible for trade reporting, even if they have delegated the function.
- The scale of regulatory reform being imposed: in order to remain competitive, firms must ensure that regulatory governance is regularly reviewed and that adequate programmes are in place to manage any operational change that is required.
- Understanding the changes that are required to address collateral segregation: the rules vary between Dodd-Frank and EMIR.
- Effects on operating models: some firms are revisiting their operating model for the processing of OTC derivatives in light of the imposition of business conduct rules under Dodd-Frank and EMIR.
- Efficient connectivity: many firms have yet to understand and implement the required connectivity solutions for new OTC services (affirmation, trade reporting, etc), all of which require proper planning, implementation and testing.

Trade reporting

ESMA's authorisation of the first trade repositories under EMIR means that firms falling under its jurisdiction now have a solid deadline for the implementation of their trade reporting solutions. Any organisation that is not fully compliant with EMIR's trade reporting requirements by 12 February 2014 risks falling foul of the regulators.

Under Dodd-Frank, buy-side institutions do not play a role in the submission to the trade repository, but they are required to verify the accuracy of reports submitted. Under both regulations, a buy-side institution has an obligation to either submit or to verify the trade details submitted to the trade repository.

This will require a control framework capable of expanding as data-sets fragment further, in an environment where the organisation has to reconcile submissions at multiple trade repositories.

EMIR requires a wider range of trade details to be reported than Dodd-Frank, some of which may not be available through common trade execution standards. This means that institutions must find a way to enrich or modify any reporting message sent to a trade repository on their behalf. As this must be completed within a specified timeline, institutions will need to assess the need for any infrastructure build and investment.

For transactions that are not eligible for central clearing, buy-side institutions should be aware of the reforms governing bilateral confirmation that will be phased in. These are being introduced in order to mitigate the risk of un-cleared transactions and will impose different requirements across asset classes. This again emphasises the need for straight-through-processing in all elements of the trade life-cycle environment, and may require an institution to assess their ability to meet these requirements.

Institutions will also be required to perform periodic portfolio reconciliations for non-centrally cleared transactions. The requirements here are determined by the portfolio size but impose another level of operational complexity, which institutions need to be aware of and prepared for.

The cost of collateral

The cornerstone of OTC derivative reform on both sides of the Atlantic is the creation of central counterparties (CCPs) and the mandatory clearing of eligible products, designed to mitigate counterparty risk. While central clearing reduces counterparty credit risk, initial and variation margin (often cash) will have to be posted at the CCP.

For the buy side, the cost of supplying what a CCP considers 'high-grade' collateral may come at a price.

The increased cost of posting eligible collateral and the lost opportunities that will occur as a result of funds being tied up at a CCP are amongst the anticipated challenges. In the short-term, CCP requirements may drive margin requirements higher than bilateral agreements, and calculations may shift to a daily and intraday basis.

It is estimated that over two thirds of current bilateral trade volumes will be cleared through a CCP in the future, splitting the market between the cleared and non-cleared products. The need for technology to process both cleared and non-cleared products may concern buy-side participants who fear an increase in operational processing and risk as a result.

Institutions can gain support from triparty structures. For instance, it can be helpful to use independent collateral agents and systems that efficiently underpin ongoing collateral reallocation and intraday substitutions based on collateral values.

Triparty agents reduce operational risk and complexity, help manage counterparty exposure, and provide clients with a wide array of solutions to transform and optimise collateral. However, choosing the right clearing agent can be challenging.

CCP/clearing broker selection

The CCP mechanism, its financial strength, and the selection of a clearing broker/s are all crucial considerations for the buy side. If there is no direct relationship with the CCP then the clearing broker assumes the credit risk and acts as the intermediary.

Buy-side firms must familiarise themselves with the options available, as the collateral taker (the CCP) sets the parameters for the collateral it will accept from the collateral provider (the buy side firm). Clearing brokers should also be reviewed for suitability and stability, as they will not only hold the firm's initial margin, but also help to clear the firm's trade in the years ahead. It is imperative that there is no repeat of the MF Global case where client funds were put at risk.

With the cost of margining increasing, risky, long-term bespoke swaps will become uneconomical, encouraging the trading of more 'vanilla' products. Indeed, it could potentially lead buy side firms to use the futures market to mimic their swaps trades given its lower margin costs and less stringent regulatory requirements. However, with the imperfect hedging provided by futures contracts, many question whether the tailored nature of swaps will actually transcend the regulatory reforms.

The authorisation of the first trade repositories under EMIR marks the beginning of the final phase of derivatives reform. Prior to this, numerous delays had lured firms into a false sense of security, which led to the mass adoption of a hesitant and gradual approach to the implementation of compliance initiatives. Now that the compliance countdown has been initiated, firms can no longer afford to have such a laid back attitude.

Conforming to the demands of the regulators is, however, no small feat. The work required to meet the correct level of compliance is substantial and should not be underestimated. The on-boarding of clients and the accompanying processes all take considerable preparation and time.

“For the buy side, the cost of supplying what a CCP considers 'high-grade' collateral may come at a price”

The updating of documentation and implementation of new infrastructures will also require significant investment. For organisations that intend to remain in the derivatives market, any unintended consequences of the reform should also be considered. This is particularly pertinent for monitoring the operational risk profile of derivatives trading.

Buy-side firms need to act fast if they are to beat the countdown and be fully compliant before time runs out and their bottom line is negatively impacted. **SLT**

Elspeth Goodchild
Buy side and delivery management specialist
Rule Financial


clearstream
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Is Hong Kong safe as houses?

With a spate of investment banks downgrading their outlook on Hong Kong property, Simon Colvin of Markit Securities Finance looks at investor sentiment in the sector and the profit outlook for property firms

Ever in the news, property prices made the headlines in Hong Kong recently when Barclays put the entire property sector on a "negative" watch. Driving negative sentiment is both Hong Kong-related issues as well as the sector's reliance on long-term US treasury yields, which have only one place to go after reaching record lows earlier in the year.

While the treasury issue is universal among hard assets that are heavily credit dependent, the large part of the Barclays argument was idiosyncratic to Hong Kong. While property in the city is currently trading at all-time highs according to official data, analysts were most worried about the impact of the recent curbs on foreign purchases as well as a possible flood of new developments, which they predicted could usher in a 30 percent fall in prices.

Sector underperforming

On the whole, the bearish sentiment expressed by Barclays is echoed by lacklustre returns across the sector. The 61 Hong Kong-domiciled real estate companies that trade locally have disappointed investors with a 2 percent average fall in the year-to-date.

The established names in the sector have fared even worse in the year-to-date. The Hang Seng Properties Index has posted a 6.4 percent fall for the year, over 8 percent behind the overall index, which is up 2.5 percent in the year-to-date.

Shorts not responding

Despite the recent downbeat share price return and bearish analyst sentiment, short sellers have actually covered their positions in Hong Kong real estate firms in recent months. The current average free float out on loan across the 61 firms that we have data for stands at 0.75 percent, the lowest in over 18 months.

China-domiciled shares that trade on the HSI have seen much more attention from short sellers, with 3 percent of average free float currently out on loan. These 21 shares have seen covering in recent weeks to 18-month lows. Interestingly, most of the short covering in the sector occurred in the second half of last year and shorts have been relatively steady in the year-to-date

Pockets of short selling

While Hong Kong shares have seen short covering pretty much across the board with the exception of China Overseas Land Development, several China-based H Shares have seen substantial increases in demand to borrow in recent months. H Shares make up the majority of the most shorted 10 firms despite the fact that they make up a quarter of publicly traded firms.

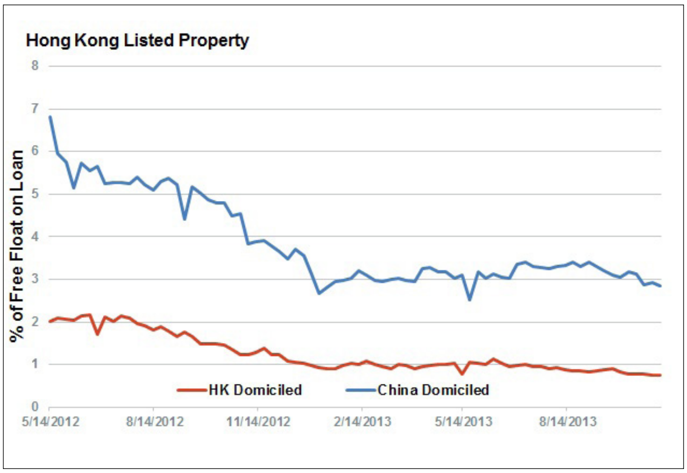
Soho China saw the largest spike in demand to borrow in the year-to-date. Demand surged to 20 percent of its free float, over a third higher than its nearest peer Evergrande Real Estate Group.

Analyst downgrades

Looking at the medium-term profit outlook across property firms, we find inconclusive evidence that the sector is forecasted to see a sustained earnings draught. Property firms have an average 50.4 rank across the Markit Data Analytics and Research 2 Year Projected EPS factor, which ranks shares based on their expected profit growth in the next fiscal year.

The fact that the sector ranks so inconclusively across a universe of Hong Kong shares shows that the sector is not subject to long-term analyst pessimism. Interestingly, the most shorted firm, Soho China, has the third worst possible rank. **SLT**

Short Name	Ticker	Domicile	YTD return	% of Free Float On Loan	YTD Change
Soho China Ltd	410	CN	9.0%	20.3	6.6
Evergrande Real Estate Group Ltd	3333	CN	-23.8%	14.0	5.9
China Overseas Grand Oceans Group Ltd	81	HK	-3.5%	11.7	5.5
Franshion Properties China Ltd	817	HK	-3.2%	7.2	2.4
Longfor Properties Co Ltd	960	CN	-16.5%	5.6	2.1
Renhe Commercial Holdings Co Ltd	1387	CN	-48.1%	5.5	-2.0
China Overseas Land & Investment Ltd	688	HK	1.7%	3.9	-1.3
Greentown China Holdings Ltd	3900	CN	5.5%	3.3	2.4
Poly Property Group Co Ltd	119	HK	-22.8%	3.0	-4.2
Shui On Land Ltd	272	CN	-24.2%	2.8	-1.7



FRFARRF: the unwind begins

The Fixed-Rate Full-Allocation Reverse Repo Facility has been clarified, but an unanswered question remains, says Oscar Huettner

On 21 August the Federal Reserve released the minutes of its July meeting. Included in these minutes was the announcement of the creation of a Fixed-Rate Full-Allocation Reverse Repo Facility (FRFARRF). This announcement appeared to catch a large portion of the secured financing markets off-guard and has elicited a number of articles speculating on the effects, intended or unintended, of this new Federal Reserve tool.

Since that initial announcement, the Federal Reserve has posted a significant amount of information on its website, which, when read through, debunks a number of the more cynical interpretations of this new tool, but also leaves a bigger question unanswered.

The FRFARRF allows market participants to ‘reverse in’ collateral from the Federal Reserve, therefore investing cash and, from the Federal Reserve’s point of view, draining liquidity from the banking system. The Federal Reserve created a pilot programme to run from 23 September until 29 January 2014. By its terms, participants can bid for up to $500 million of collateral on an overnight basis (this could be increased to as high as $1 billion). Rates were set at 0.01 and could be raised to as high as 0.05. The window for these operations is between 11:15 and 11:45am EST. Only the Federal Reserve’s treasury securities are to be used.

Currently, 139 institutions are eligible to participate: at present, this includes 21 primary dealers, 18 banks, six government-sponsored enterprises (including Fannie Mae and Freddie Mac) and 94 large 2a-7 funds. This facility contrasts with the Federal Reserve’s traditional reliance on its primary dealer network exclusively to affect short-term monetary policy. The first operation was conducted on 23 September, and subsequently the Federal Reserve announced on 26 September that it would increase the maximum allocation limit to the $1 billion level.

The market can often overreact when a surprise announcement comes from the Federal Reserve. It was immediately pointed out that the central bank would now be conducting open-market operations directly with market participants at the expense of its primary dealer network. Some speculated that the creation of this new facility could partially reflect the Federal Reserve’s dissatisfaction with the pace of triparty reform. Finally, there was the prediction that the central bank’s presence in the overnight markets could raise dealers’ financing costs and serve as another lever to force them to reduce their balance sheets.

While the FRFARRF will undoubtedly alter the short-term funding markets, it is worth reading the Federal Reserve’s comments on the purpose of this facility as it is explained on its website.

The Federal Reserve makes two key points. First, the facility will complement the its payment of interest on overnight excess reserves, allowing the central bank to directly influence short-term secured and unsecured rates. Second, the facility is intended to work in conjunction with the Federal Reserve’s more traditional capped allotment repos. The central bank goes to great lengths to refer to this facility as an operational exercise, but it seems likely that an expanded FRFARRP is intended to play a major role in the Federal Reserve’s transition from its current accommodative stance to one where it will be withdrawing liquidity.

The most obvious consequence of an expanded, permanent FRFARRF would be the creation of a floor under overnight repo rates. If an institutional investor can access collateral from the Federal Reserve at 0.25 in the late morning, the investor will demand a higher rate from its market counterparties in the early am. The interesting question is how much of a premium dealers will have to pay.

While some market commentators have speculated that the Federal Reserve has abandoned its traditional reliance on its primary dealer network, an alternative explanation may be that it recognises that with all of the regulations aimed at limiting dealers' leverage, they may not be able to play their traditional role of serving as a conduit for the Federal Reserve's open market operations. Other considerations may be the central bank's ongoing efforts to ensure the viability of 2a-7 funds and to compensate for collateral shortages around reporting dates.

The big winners appear be Fannie Mae and Freddie Mac, as they can now buy repos from the Federal Reserve, whereas they currently cannot access the IEOR programme. This will further reduce the volume in the overnight Federal Reserve funds market, as Fannie Mae and Freddie Mac currently have no alternative but to place their excess liquidity there.

Now, for the unanswered question: will the Federal Reserve rely exclusively on the overnight repo market to unwind quantitative easing when the time comes to withdraw liquidity?

As of the 25 September, the Federal Reserve held $3.45 trillion of securities in its System Open Market Account (SOMA) programme, $1.96 trillion of treasuries and $1.34 trillion of agency mortgage-backed securities (MBS), with the remaining $151 billion made up of treasury inflation protected securities and agencies. That compares with a range of holdings between $473 billion and $786 billion between July 2003 and September 2008.

The post-crisis target for the Federal Reserve's SOMA account will be contingent on many factors, but it does not appear to be unreasonable to anticipate that the central bank will ultimately have to shed between $2 and $2.5 billion of assets in its unwind.

Obviously, the first steps that the Federal Reserve will undertake will be to taper its monthly purchase of securities and then cease quantitative easing altogether. This is widely expected to begin before the end of 2013. Federal Reserve chairman Ben Bernanke has indicated that he does not expect rates to rise until mid-2015, almost two years from now. This anticipated increase in rates has been tied to a fall in the unemployment rate below 7 percent. Ignoring the possibility of accelerated economic growth, let's focus on mid-2015 as the point where the Federal Reserve begins to withdraw excess liquidity.

The run-off of the Federal Reserve's SOMA holdings is minimal between now and mid-2015. The treasury portfolio has $2 billion of maturities over the next 21 months, and the only other reduction will come from principal pay downs on the Federal Reserve's MBS holdings. But what about SOMA's maturity profile going forward? Beginning in mid-2015, the SOMA portfolio pays down $144 billion in year one, $170 billion in year two and $261 billion in year three. Contrast this with the increase of almost $900 billion in the Federal Reserve's holdings between September 2012 and September 2013 and you will see the task that the central bank faces in unwinding quantitative easing.

While it is likely that the pace of the unwind of quantitative easing will be slower than its build up, it still appears that the Federal Reserve will have to take steps to withdraw liquidity from the financial markets at a pace that substantially exceeds the SOMA runoff.

The Securities Industry and Financial Markets Association's 1 October 2013 published statistics reported a daily average of approximately $1.5 trillion of treasuries outstanding on repo transactions during September. The obvious question becomes how much more treasury collateral can the market absorb on a short-term basis. With markets currently trading toward the bottom of the Federal Reserve's 0.00 to 0.25 range, there clearly is a fair amount of slack that can be taken up.

But if the Federal Reserve is faced with the need to aggressively withdraw liquidity, it may find that this task exceeds the market's demand for overnight investments. The question that the central bank has left unanswered is whether it will also establish a programme for reducing its SOMA holdings through outright sales. **SLT**

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"Will the Federal Reserve rely exclusively on the overnight repo market to unwind quantitative easing when the time comes to withdraw liquidity?"

Industry appointments

Equity finance exchange OneChicago has named **Waseem Barazi** as its chief regulatory officer.

Barazi previously served as director of market regulation at OneChicago, which he originally joined in 2011.

He later joined the Financial Industry Regulatory Authority (FINRA), where he was responsible for surveilling and analysing market data, as well as conducting investigations of potential violations of FINRA rules and federal securities laws.

In his new role, he will be based in Chicago and report to the exchange's oversight committee and its CEO, David Downey.

As chief regulatory officer, Barazi will be responsible for providing strategic leadership and counsel on all regulatory, compliance and commodities and securities law issues for OneChicago, and will serve as its primary liaison to the Commodity Futures Trading Commission and the SEC.

"While Barazi brings an extremely high intellect and a background in law and compliance, it is his self-propelled personality and understanding of technology that makes him ideally suited to this new job," said Downey.

"OneChicago is a growing equity finance exchange operating in an evolving regulatory landscape, and I'm looking forward to helping the firm navigate those changes while continuing to maintain its regulatory and compliance efforts," added Barazi.

Thomas Squeri, head of prime services equity finance for Americas, has left Barclays.

Squeri had worked at Barclays since 2010 after leaving Morgan Stanley, where he spent almost 20 years in various capacities, including head of the supply group and chief technology officer for its securities lending business.

He joined alongside nine new managing directors that were hired in an attempt to grow the Barclays prime services business. Ajay Nagpal, head of prime services, said at the time: "These senior hires demonstrate our commitment to expand our prime services business and reflect our ability to attract premier industry talent."

The move follows the departure of **Ashley Wilson**, who was global head of equity financing and European prime services head.

Following Wilson's departure, Barclays's head of global prime brokerage, **Marty Malloy**, will relocate to London from New York.

Barclays declined to comment on Squeri's departure.

Timothy Keenan has joined BondLend as global product manager.

He will take up the position immediately and will be based in New York. Keenan replaces Oscar Huettner, who left BondLend on 12 July to pursue other interests.

Brian Lamb, CEO of EquiLend, said: "Keenan has extensive experience in the fixed income securities finance business, and we are thrilled to welcome him as the new global product manager of BondLend. His expertise in the securities lending, repo and prime brokerage businesses will be an invaluable resource for BondLend as the platform continues its considerable growth."

Keenan added: "I am excited to be joining BondLend at a time when the industry is undergoing dramatic regulatory transformation. BondLend is poised to help our clients with innovative and dynamic solutions to address these changing times. My most recent experience in electronic trading, along with my background in the global fixed income markets, will allow me to significantly contribute to the continued success of the BondLend trading platform."

Keenan left Quadriserv, where he was head of sales and business development, after four years at the company. His departure was confirmed in August.

Prior to this role, he worked at Barclays Capital, and was the global repo product manager at Credit Suisse First Boston.

Beatrice O'Carroll has joined Citi as a senior sales and client relationship manager responsible for covering clients in the Americas for the securities finance group. She will be based in New York.

Most recently, Beatrice managed institutional client relationships in the US and Europe for Fischer Francis Trees & Watts.

Dave Martocci, global head of securities finance at Citi, said: "As we continue to win significant business in both the third-party and custody lending space, the opportunity to hire [O'Carroll] with her tremendous experience and knowledge will help round out our global team and strengthen our efforts in the marketplace."

Satvinder Singh, Deutsche Bank's global head of trust and securities services and cash management financial institutions, has been appointed to the board of directors of Euroclear and Euroclear SA/NV.

Singh said: "Euroclear plays an integral role in tackling the challenges the securities services sector is facing. New regulations, ambitious market infrastructure changes like T2S and macro-economic challenges are adding complexity to the business model but this is also a time of great opportunity."

"I'm excited at the prospect of working with Euroclear and the distinguished members of its board. Despite the challenges we face as an industry, I believe that those with a long term vision and a commitment to exceeding client expectations will continue to flourish."

Werner Steinmueller, head of Deutsche Bank's global transaction banking division and member of the group executive committee, added: "Singh's elevation to the board of Euroclear is not only recognition of his leadership and expertise, but also an acknowledgement of the strength of Deutsche Bank's franchise and market position." **SLT**

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Company reg: 0719464