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The big deal

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Martin Gilbert
speaks ahead of
creating the UK's
largest asset
manager**

**Beneficial owners special report
Futures and options trading trends
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Record assets in UCITS and AIFs despite 2016 turbulence

Money market funds saw sales rise by €29 billion, to €106 billion over the year

<http://bit.ly/2mG7yIY>

Buy-side struggling with variation margin – Iosco

The CFTC delayed implementation of the variation margin deadline to September 1

<http://bit.ly/2lsqg53>

Hedge funds outflows to taper off in 2017 – Barclays

Analysts at Barclays believe that hedge fund outflows will eventually begin to taper

<http://bit.ly/2lcEV52>

Data integration an issue for investors

State Street poll finds data aggregation one of the biggest challenges that investors are facing

<http://bit.ly/2mulZCS>

US college endowments struggle in 2016

Average -1.9% return last year for US college and university endowments

<http://bit.ly/2musd5V>

Buy-side mistrust in IT “alarming” says SimCorp

SimCorp’s newest MD Stephen Butcher speaks to Global Investor on the latest survey

<http://bit.ly/2muoapW>

Asset managers “well prepared” for US settlement switch

Most asset managers are ready for a shorter settlement cycle in the US

<http://bit.ly/2ldB1N1>

Buy-side traders shifting to mid-size brokers

Bulge-bracket brokers losing electronic equity business as trading desks seek greater customisation

<http://bit.ly/2IUP3Sz>

Private equity managers fret over fundraising and regulation

European private equity funds are concerned by market regulation for 2017

<http://bit.ly/2m9DozT>

Short sellers trim positions as US bull market continues

Demand to borrow shares across US stocks is down by 10% since US election

<http://bit.ly/2mutJol>

CUSTODY & FUND SERVICES

Northern Trust buys UBS fund services units

Northern Trust will become the fund administration services provider for \$413bn in assets

<http://bit.ly/2munPng>

RBC’s asset servicing arm sees quarterly profit double

Division sees profit double on back of higher interest rate and FX volatility

<http://bit.ly/2IXzFDa>

Ireland assessing CSD options as Brexit concerns grow

Irish Stock Exchange engaged with the market on options for a CSD for Irish securities

<http://bit.ly/2IdEPHs>

Asset servicing could hold opportunity for hedge funds

Hedge fund managers have opportunities to enter new lines of business, BCG experts argue

<http://bit.ly/2Idue66>

Dubai bourses set for post-trade overhaul

Nasdaq Dubai shares a trading a post-trade platform with DFM

<http://bit.ly/2mutOnm>

Blockchain backers bullish on post-trade impact

Blockchain advocates believe technology could be widely in use across post-trade market by 2020

<http://bit.ly/2IUERDb>

US T+2 settlement enters crucial testing phase

Shorter cycle set to improve operational efficiencies and reduce counterparty risk

<http://bit.ly/2I72GOQ>

Wave 4 migration puts T2S concerns to bed

Most major European CSDs now directly connected to T2S

<http://bit.ly/2m9E0pd>

BNP Paribas seals Spanish custody deal

Spanish insurer Mapfre will outsource custody services to the French bank

<http://bit.ly/2IXqcMw>

Euronext appoints third Lisbon chief exec in a year

European exchange group has approved the appointment of Paulo Rodrigues da Silva

<http://bit.ly/2IA5RM6>

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INTERNATIONAL SECURITIES FINANCE

PGGM looking to clear stock loan trades via Eurex

Morgan Stanley and BNY Mellon's support for Eurex big factor in PGGM's decision
<http://bit.ly/2lssyRt>

DTCC's blockchain repo trial moves ahead

Working group to be formed after successful post-trade tests
<http://bit.ly/2m9N9y2>

SG taps Lombard for bank-wide collateral strategy

French bank already uses Lombard's Colline solution for OTC Repo and clearing
<http://bit.ly/2mLQmRs>

Sec finance exec Grimaldi resurfaces at RedBlack

Grimaldi says a "change of guard" is occurring in the securities finance industry
<http://bit.ly/2mui4pl>

Vendors up the pace to get SFTR solutions in shape

Pirum and IHS Markit have teamed up to tackle SFTR
<http://bit.ly/2mg2EC6>

Clearstream, Eurex boost Deutsche Boerse

Frankfurt group said in results statement that ruling on its planned LSE merger due next month
<http://bit.ly/2IULDiK>

Scrip dividends spur European sec lending returns

Scrip dividends are continuing to boost fees across the European securities lending market, statistics from IHS Markit show.
<http://bit.ly/2muxD0q>

No let-up in SFT transparency drive

Achieving transparency remains critical to regulators despite potential policy upheaval
<http://bit.ly/2IUVs0d>

Malaysia modifies SBL rules amid rising volumes

Malaysia is the seventh largest market in Asia Pacific in terms of equity lending revenues
<http://bit.ly/2IUN54C>

India lowers SBL fees in bid to boost activity

Securities lending fee structure changed as part of incentive scheme
<http://bit.ly/2ldG4gF>

FUTURES & OPTIONS

CME to part ways with two senior US directors

Terry Duffy replaced Phupinder Gill as Merc chief executive at the end of last year
<http://bit.ly/2mhrXCP>

FCA to "use judgement" over variation margin rule

CFTC has delayed enforcement on variation margin rules until September 1
<http://bit.ly/2lgYHQG>

Swaps Trading under Mifid II – Lessons from US

European firms should prepare for different outcomes from Mifid's swaps trading rules
<http://bit.ly/2kiDNOX>

20 ex-Tower traders join rival Vega Capital London

Ex-TT head of ops Spires and risk manager Gaunt have joined Vega Capital
<http://bit.ly/2mieqih>

IBA head Hutcheson set to run ICE Clear Europe

Paul Swann, who has run ICE Clear Europe since 2008, to retire in mid-year
<http://bit.ly/2IXjN5e>

ETF industry reaches new high of \$3.7 trillion

The global ETF industry has now increased in size every month for three years
<http://bit.ly/2miOTaw>

ICE to acquire TMX Atrium from TMX Group

ICE said TMX Atrium is to become part of its vast Data Services business
<http://bit.ly/2mOzJo0>

ICE reports 2016 revenue up 27% off IDC acquisition

ICE rival CME Group reported Thursday a 12% rise in revenue for the year
<http://bit.ly/2mwA8iT>

Esma to focus on clearing equivalence, repositories

There are 21 equivalence recognition requests pending for non-EU clearers
<http://bit.ly/2lw57qk>

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Considering how much money continues to be invested in smart beta by pension funds and via the explosive global growth of exchange traded funds, there is regrettably little independent research into how well strategies perform. The asset managers and others promoting the strategies do of course have back-tested models, which show prospective clients what they might expect in terms of out-performance, but it is hard for the client to tell whether this is smart investing or smart marketing.

Objective independent research is scarce but it is scarce for a reason. To be useful it has to look at performance over the very long run. Few academics have easy access to the required data sets.

Luckily there are exceptions. When all three were at London Business School Professors Elroy Dimson, Mike Staunton and Paul Marsh began to compile what is now the world's most comprehensive study of the long-run behaviour of equities and bonds. They burst on the scene with *Triumph of the Optimists* published in 2000, which charted how equities had trounced bonds over the last 100 years in London and the other major markets. The database has been extended each year since and their work now takes in most of the world's major markets.

Testing claims

They set out to answer two questions: is smart beta really smart and is smart beta persistent? And, can the factors that tilt a portfolio deliver lasting outperformance? The results appear in the recently published Credit Suisse Investment Returns year book.

Over 300 different factors have been isolated over the years and obviously they could not test every single one. Instead they focussed on the five most commonly used – value, momentum, size, low volatility and income.

First of all they plotted these on a grid to grade performance since 2008. These last 10 years show considerable volatility. What they found however was that a factor which drives performance one year may well fail to do much the next. Thus, over the 10 analysed years the low volatility factor delivered three years of top quintile performance, three years in the bottom quintile and four around the middle. The size factor delivered three years at the top but only one year at the bottom. Momentum also had three years at the top and one year at the bottom. Value had one year at the top and five years at the bottom. Income never made it to the top, but was never at the bottom either. It spent all 10 years in the middle three of

Judgement day

Smart beta has boomed while its marketing claims remained impossible to substantiate or refute, says *Anthony Hilton*, but credible data is now available




“All factors make a difference, but most are generally benign but there is an ever-present danger of factor reversal”

the quintile bands with a bias towards the lower.

Over the 10 years most factors had their time in the sun. But there was no persistency and no pattern and no way of knowing in advance which was likely to do well. And of course the analysis ignores the impact of costs. Some smart beta strategies require a large amount of dealing, others in the long-short space can be difficult to construct. Theoretical outperformance may not be achievable.

Over periods of 50 years or more they discovered similar uncertainty. All factors make a difference – most are generally benign but there is an ever-present danger of factor reversal. For example, over 50 years value significantly outperforms growth. But there are periods when it goes painfully the other way and that is when all but the most resolute clients get shaken out.

Similarly small caps significantly outperform large caps in a 50-year run but there will be periods with durations of 10 years or more where the opposite is the case. It is worth considering too whether the outperformance is simply the rewards for extra risk and illiquidity.

Overall the data shows that portfolios tilted by individual factors or a combination of them will behave differently from the market as a whole and this is something investors cannot ignore. But that effect can be down as well as up; and that is also something investors cannot ignore. Smart beta is not smart all of the time. 

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Valuable alternative

Alternative credit, or private debt, can play an important role over the market cycle, says NN Investment Partners' *Gabriella Kindert*



Quantitative easing has caused a significant distortion of market dynamics and had an enormous impact on the price of most publicly-traded liquid assets, leaving investors looking for alternative solutions. Alternative credit, or private debt, is a dynamic, complex and extensively evolving market that can provide multiple benefits to investors and it has already become the cornerstone of many institutional portfolios.

Across Europe 52% of pension plans are now invested in private debt and most of them report that their investment has delivered value. The adoption rate is likely to rise to 80% by 2020 as the search for uncorrelated absolute returns intensifies, according to a 2016 Create Research survey.

Alternative credit can improve risk-adjusted returns and enhance income several ways: a return enhancement over public markets, defensive positioning and a contribution to diversification.

Private pricing differential

There is a clear consensus and rich academic literature that supports the existence of so-called illiquidity premium in private markets, which can be substantial over time. We prefer to give a broader interpretation on how the value is derived on private markets and refer to the private pricing differential (PPD). The private in PDD allows for excessive return. The premium in private debt is not only to compensate for illiquidity – it is the result of multiple attributes.

The first attribute is structuring features, based on a specialised understanding of the asset classes that results in higher recovery in case of default. The recovery rate is often more than 80%, which is significantly higher than the reported figure of 38.4% of Moody's for public markets related to senior unsecured bonds ranging from 1992 through 2006. The second attribute is sourcing, which entails connecting sellers and buyers, matching demand and the supply of capital. The final one is a higher degree of control and flexibility, allowing adjustment of terms to changing economic circumstances.

So how big is the PPD? Contrary to public traditional fixed income markets, alternative credit offers an attractive 50 to 500 bps over the fixed income market. In other words, for the same credit rating, private debt can offer significantly higher return than a public debt instrument, which is perceived to be more liquid.

This differential begs the question of whether investors are

overpaying for the perception of liquidity on public markets. Several recent publications by regulatory institutions suggest that liquidity in bond markets has changed, which can be attributed to the increase in regulation of the financial sector. Consequently, investors need to consider the risk of structural change toward lower liquidity as well as the volatile nature of liquidity on public markets.


Defensive properties

Private debt is a defensive asset class and, in recent years, our world has become increasingly complex. Assumptions and facts change faster than ever before. In these uncertain times, alternative credit can offer a plausible answer as the exposure is mostly secured by the assets and shares of companies.

Further, alternative credit offers mostly floating-rate exposure, which is a natural hedge against the risk of rising inflation. It may enable exposure for shorter tenors to self-liquidating assets (such as trade finance, factoring and supply chain finance). In uncertain times, when we feel less committed to invest in illiquid assets for the longer term, focusing on the shorter term of the asset cycle (especially on a secured basis) might be more rewarding as it enables more flexibility for portfolio repositioning and scenario planning.

Alternative credit offers portfolio construction opportunities, providing diversification into asset classes traditionally owned by banks. In Europe, a good example is SMEs, which are a primary source of economic growth, representing two-thirds of employment, while most have no access to public markets.

The exposure to this segment offers multiple benefits in terms of diversification: exposure to the future economy; exposure to less volatile segments; and greater flexibility and control to influence investment performance by adjusting structures to reflect the changing risk-adjusted return environment.

Alternative credit has already become the cornerstone of investments in many institutional portfolios and has become a regular source of income. The recent performance of private debt has exceeded the expectations of most of the investors. Alternative credit offers several benefits: PPD, diversification opportunities and a defensive character that could offer significant over-performance and contribute to higher investment yields compared to public instruments. 

Gabriella Kindert is head of alternative credit at NN Investment Partners

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The final countdown

Defined benefit (DB) pension schemes across the developed world are struggling to cope with the rising cost of providing benefits. Longevity has risen rapidly since these schemes were set up, often in the 1970s or even earlier. By 2030, life expectancy will exceed 90 years for the first time, initially for women in South Korea but with most other developed nations not far behind, according to a study by the UK Medical Research Council and the US Environmental Protection Agency.

As these pension schemes mature, many are being forced to liquidate traditional return-seeking assets such as equities and corporate bonds to service negative cash flows, where pension payments exceed new contributions. Consultancy Hymans Robertson estimates that around 57% of FTSE 350 DB pension funds are now cash flow negative, and the figure is even higher in the US, at 82% of S&P 500 company schemes, suggests Goldman Sachs.

In the UK, the collective deficit of DB funds is around £1trn, though the figure rises and falls with the gilt yields used to calculate liabilities. The scale of the problem has made it a political issue, particularly as earnings of FTSE350 companies have been declining. It has raised the questions of how companies will be able to keep their pension promises to members and how to deal with the detrimental impact deficits are having on corporate activity such as mergers and acquisitions.

Elsewhere in Europe, the corporate world faces a more significant burden. In fact, in Europe, final salary schemes account for 14.9% of total staff costs, more than double the 6% for British

Many defined benefit pension schemes are past their peak size and are overhauling their investment strategies to manage their decline, says *Ceri Jones*

companies, according to consultancy Barnett Waddingham.

After decades of focusing on bond-based liability-driven investment (LDI) strategies to reduce risk, the new thrust is to build terminal portfolios for the run-off phase, using secured finance that more closely matches the scheme's cash flow. Much of the hype is concentrated on infrastructure assets, and President Trump's promise of a massive fiscal expansion and infrastructure spend has

helped to encourage this thinking. The US pension market is not quite as mature as the UK – lagging by around five years – yet it faces the same issues.

"There is a lot more focus on a better understanding of cash flows," says Phil Edwards, European

director of strategic research at Mercer. "More schemes are looking to build out their exposure to income-generating assets that reflect their liabilities, particularly credit and real assets that broadly match their [outflows] and have some inflation sensitivity such as long-lease property, infrastructure equity and debt."

Activity is very scheme-specific but "it can be a material shift of 30% to 50% of the pension scheme's portfolio into these less liquid income-generative assets", often at the expense of equities, corporate bonds and gilts, depending on where a scheme is starting from. "Many of the schemes that are adopting a cash flow driven approach are in a low

risk position already, and so will more likely be moving out of bonds. These are typically schemes that are reasonably well-funded on a prudent basis, that have a good sponsor and are able to adopt a longer time horizon."

Not all schemes are in such a fortuitous position. "Schemes that still face a large funding gap will need to continue to focus on closing it and will therefore need to stay invested in equities," adds Alan Baker, UK head of DB risk at Mercer. "But even the less well-funded schemes can start to adopt this new approach, for example by segmenting, such as matching their pensioner liabilities to assets such as illiquid alternative credit options but retaining growth assets for their deferred members. Moving to a cash flow-matched basis is on the agenda for many types of scheme, and in the UK the Regulator has made specific demands about this."

Inadequate supply

The challenge, however, is the limited supply of inflation-sensitive long-term assets. Infrastructure debt is even longer dated than long property leases at 15+ years, but has seen yield compression of around 50-75 basis points over the last 3-4 years.

"There is a growing appreciation that DB pension schemes face a serious shortage of investments to fit the purpose, i.e. long-dated inflation linkage, and there is a greater role the government could play in facilitating that," says Chris Redmond, global head of credit at Willis Towers Watson. "Another option is the small universe of long-dated inflation-linked corporate

"Schemes are looking to build out their exposure to income-generating assets that reflect their liabilities, particularly credit and real assets"

PHIL EDWARDS, MERCER

bonds, for example pseudo utilities. Some firms are also exploring the potential for pooled funds invested in second mortgages where elderly homeowners have remortgaged to boost their income."

While he prefers clients to diversify across secured finance instruments, he says the firm has looked at a range of assets, "some of which we like but the majority we don't".

Activity is growing strongly however. "Since we started investing into secure income in 2008, we have had circa £4bn invested or committed to this space. This has really increased recently, with approximately £2bn committed since December 2015," Redmond adds.

"However, by basic valuation measures, established assets in this area have been getting more expensive and we do believe it will be a 'buy now while stocks last' situation, and that there will be a shortage of this type of stock even with the fiscal expansion and more assets coming on line. It will be a race to the bottom."

Very big pension funds with their own internal teams may manage these assets in-house but the large majority will use a segregated or comingled fund, typically targeted at the gilt rate plus 2%.

Although there are several pooled funds with low minimum investment thresholds, so far activity has largely been limited to larger pension schemes because of complexity and the governance challenge. On the supply side, although some asset managers are breaking into this market, there are non-negligible barriers to entry such as operational experience, administration and expertise and this has inhibited the flow of new funds.

Long-term commitment

There is also a heavy sustainability angle to this approach. Run-offs typically take place over a 20-plus year timeframe so scheme trustees need an understanding of how the world will evolve, including likely governmental and societal developments. Pension funds are increasingly employing the services of specialist covenant advisers to sketch out the future. It does not help that few

bond managers do this well; it's been a bigger focus for their equity-focused peers.

Redmond also points out that cash flow-matched assets need to be in the domestic currency, so this is part of a broader trend to move back from unconstrained global investing approach to a greater domestic focus. "It is bringing us to a much simpler world and there are real attractions to that," he says.

At the same time, some employers are looking at how to better assess their liabilities, using a roll-forward approach in addition to the discounted model to give more clarity. There is also increased use of special purpose vehicles; these can take the form of a company-owned asset or even a brand, essentially anything that can be harnessed to provide a cash flow.

Inflation is also ticking up globally. While it is not a new risk for pension schemes, it adds another layer of complexity. Many schemes have inflation hedges built into their LDI strategies, but with the primary focus on buy-and-hold credit, there is less concern about inflation and much greater concern about interest rates and longevity risk. There is therefore considerable demand for inflation hedging. Mercer has captured much of this market, completing six major hedging transactions for pension funds last year.

"As recently as yesterday [21 February], we saw a record order book for an index-linked gilts syndication with the biggest set of orders seen so far – with almost six times the amount of bonds sold, even though real yields are minus 1.5%," says Robert Gall, head of market strategy at Insight Investment. "This is one illustration of the level of demand there is for inflation hedging."

It also demonstrates how hard pension scheme assets are required to work to meet a wide set of demands. In this environment, secured finance investments are becoming an invaluable part of the armoury, providing a bridge between return-seeking assets and

liability-matching portfolios, and able to offer some control and certainty over the timing of returns.

"Clients are not only looking to alternatives and real assets, but are at the same time also seeking contractual cash flows," Gall adds. "Clients have a lot of things to consider – they are trying to use assets to hedge, and deliver cash flows and seek total returns. These are not necessarily distinct and certainly we think need to work together to deliver an integrated solution."


Dividends vs contributions

Meanwhile, ballooning deficits and their impairment of corporate activity have prompted the British government to issue a green paper on the future of DB schemes. Published in February, it offers few solutions – and noticeably omits some of the uncomfortable facts that led to its conception. One of these was that FTSE 100 companies paid

their shareholders five times more in dividends (£71bn) than they spent reducing their pension deficits last year, according to analysis by Lane Clark & Peacock.

In the event, however, there has been little appetite for the concept of capping

dividends while companies address their deficit problems. "The ongoing use of quantitative easing has horribly distorted the discount rate by which DB pension schemes are calculated, meaning liabilities have ballooned over the last few years," says Rob James, financials analyst at Old Mutual Global Investors.

"The result is that any action corporates take to reduce their deficits today is likely to prove to be totally superfluous in a few years' time. With this in mind, the suggestion to cut dividends, which provide a much-needed income for many shareholders, seems unnecessary. The largest shareholders are institutions, including pension funds and charities, so stopping dividend payments would mean cutting the income of exactly those that need the help." 

"There is a growing appreciation that DB pension schemes face a serious shortage of investments to fit the purpose"

CHRIS REDMOND, WILLIS TOWERS WATSON

The big deal

Orchestrating a merger with Standard Life to create the UK's biggest asset manager is an uncharacteristically defensive move by Aberdeen CEO Martin Gilbert, says *Alastair O'Dell*, but it is the right decision for the business

For many months Aberdeen Asset Management has faced the same awkward question of how it will reverse its recent slump. What strategy could co-founder, CEO and famed dealmaker Martin Gilbert come up with to turn things around?

We found out on 4 March, when Aberdeen was rushed into revealing its strategy when news broke of it being deep in merger discussions with Scotland's biggest asset manager Standard Life. The £11bn (\$13.5bn) all-share merger will entail Aberdeen shareholders receiving 33.3% and Standard Life 66.7% of the combined group, for which Gilbert and Standard Life CEO Keith Skeoch will be co-CEOs.

Aberdeen has had torrid time over the past couple of years, finding itself on the wrong side of some powerful industry trends. It had been hemorrhaging assets, losing £100bn in outflows over 15 consecutive quarters, and its share price fell precipitously between April 2015 and February 2016, from a peak above 500p to a low barely above 220p, before heading to 270p on the eve of the merger announcement.

The long-term trend vexing all active managers is the steady drift to passive management and the associated pressure feeding through into active fees, which could still have much further to run. "I wish I knew the answer to that – then we could plan much more efficiently," says Gilbert. "My instinct

is that it will get tougher in the big developed markets. In emerging markets we are not seeing as much fee pressure. It's going to get tougher."

The second issue for Aberdeen was the cyclical shift to the resurgent US economy, where it is weak, at the expense of the long-term 'rise of Asia' story, where it is particularly strong. The problem is not with its performance – it perhaps does not match its glory days of the 2000s but is certainly respectable – but more that sentiment left its core markets and competitors had narrowed its edge.

"I do not think it will be the end, sadly," says Gilbert, anticipating another quarter of outflows. "We have just got to manage the business, and there are opportunities."

M&A experiences

Since co-founding the firm in 1983, Gilbert has made more than a dozen acquisitions including some in difficult times. Perhaps the most notable was in the wake of the split-cap miss-selling scandal in the early 2000s it when emerged from an existential threat to purchase the underperforming old Deutsche Asset Management (DeAM) business. It was a hugely successful move, against the odds achieving high levels of investor retention and giving Aberdeen back its "fighting weight", as it was described in the cover story of *Global Investor* back in January 2006.

There has been a long string of

deals since (including Credit Suisse and RBS businesses as well as Scottish Widows) that led to it becoming the second largest Scottish asset manager, behind Standard Life. It bought largely unloved business and consolidated their funds into Aberdeen, leaving Gilbert undisputedly in the hot-seat of a firm unified by a strong company ethos.

"We started with £50m – the only way we could grow into one of the biggest independents in the world was both organically and inorganically," says Gilbert. "It's not easy but hopefully we know what we are doing. It's a pretty well oiled machine, ready to swing into action and do what is necessary."

This time around a big acquisition faced significant barriers. Declining revenues made it unlikely that sufficient capital for a destiny-shaping acquisition could be found internally. It also faces calls for greater regulatory capital and expectations from shareholders to return capital. A small acquisition could have been made but that could have proved a distraction and would not have addressed the fundamental issues.





Gilbert is well aware that the market is moving in the direction of managers needing a comprehensive product offering. “You have now really got to be able to manage everything across the board, because of the tremendous search for yield that is happening in the world.

“We have got to be big in alternatives and multi-asset because those are the growth areas and potentially those of the future,” he says, noting that property, absolute return bond capability and direct loans are all also important.

Standard Life

Standard Life has a complementary set of strengths and a different set of problems, while possessing a compatible culture and offering the potential for synergies and cost savings. It has been moving away from insurance into asset management, is predominantly focused on actively managed fixed income, and

has successful investment platforms and asset management interests.

CEO Skeoch has a longstanding aim of turning the firm into a “world-class investment company”. It has a blockbuster offering in its £48bn AuM Global Absolute Return Strategies (GARS) fund range. It had been a darling of investors for more than a decade but after significantly underperforming last year, for the first time, its high target of cash+5% experienced outflows of £4.3bn, and now faces competition from Aviva in the sector it created.

Standard Life’s share price has followed a trajectory not dissimilar to Aberdeen’s; it peaked in May 2015 just shy of 500p and hit a low of 271p July 2016, before partially rebounding to 378p ahead of the merger announcement.

What the merger undeniably brings both firms is economies of scale. Combined, it will be the biggest asset manager in the UK, overtaking Schroders, and the second biggest in the EU, with combined revenues of AuM of £660bn. Cost savings of £200m have been mooted by analysts, suggesting job losses of around 10% of the combined firm.

The merger arrests the corrosive effect of losing AuM on Aberdeen’s profitability, which was leaving overheads spread over a dwindling revenue base.

“You either need to be a boutique with a terrific operating margin or be very big to be able to sustain the overhead of running a big global business”

“I think the big are going to get bigger – the place not to be is in the middle ground. You either need to be a boutique with a terrific operating margin or be very big to be able to sustain

the overhead of running a big global business,” says Gilbert.

Gilbert says that scale calculations should be all about revenue, identifying the sweet spot for generating economies of scale. “I disregard AuM and look at revenues,” he says. “A global player probably needs \$1bn while a domestic [UK] one can probably do well with \$500m. A boutique can do very well at sub-\$100m. The issue is if you are in that middle bracket.”

Aberdeen had nothing to fear in this rough calculation as he estimates revenues for the year to be \$1.4bn, depending on exchange rates, but increasing scale this dramatically will certainly bring substantial savings.

Broadly, there were two plausible types of deal under consideration – strategic and consolidation. A strategic deal, such as Henderson’s \$2.6bn transatlantic purchase of Janus by announced last October, could have provided internal diversification and opened up new markets. “America is the place because half of the world’s wealth is there,” he says. “It’s why the Henderson-Janus deal is such a clever deal in a lot of ways.”

The timing was not right for a transatlantic partnership – if Gilbert intended to retain control, which is hard not to imagine being the case – given the Brexit-induced sterling slump and Trump-elevated dollar.

Merging with another UK entity, with a share price denominated in pounds and under similar pressure, meant both could enter an all-share deal in a position commensurate with their longer-term relative values. The size of the combined group also makes it a less likely target for unwanted buyers.

Cultural compatibility

Aberdeen is inseparable from its ethos of research-based, high-conviction active management. The top layer of management has remained largely together for three decades – including Hugh Young, Andrew Laing and Bill Rattray among others – although there were some key departures last year including CIO Anne Richards.

“We have never, ever questioned whether being a long-term, bottom-up fundamental investor is the right approach,” says Gilbert, who notes that the firm’s ranks are full of people that joined via the graduate trainee scheme.

Aberdeen is famed for its team-based approach, which some have suggested could lead it be vulnerable to losing its leading lights. In reality, this has rarely happened (technology fund manager Ben Rogoff is a notable exception) and has protected against style drift.

It is demonstrably committed to true active management and cannot be accused, as many have been following an FCA study last year, of charging active fees for passive performance. "Our tracking errors are so large that no one

can accuse us of being a closet indexer," he says (confirmed by Morningstar data). "I agree with everything in the FCA report."

It puts him in the same camp as Daniel Godfrey, who acrimoniously left the chief executive role at the Investment Association in 2015 after some members complaining of an undue focus on consumer protection. "I agreed with everything that Daniel suggested. I am totally in favour of transparency, totally in favour of a single fee," says Gilbert.

With such a strong culture it was important to find a partner with a compatible outlook. "You have got to have a similar philosophy, because if you don't it just doesn't work," he says.

It is hard to imagine Aberdeen integrating a hedge fund business given its aversion to star managers: "Probably not, just because of the cultural differences." Likewise, an ETF business would sit awkwardly with its reputation and anyway "that is for the really big guys, such as BlackRock".

The merger with Standard Life is a better fit than some previous Aberdeen acquisitions. However, for the first time, it will be the junior partner and the process will not be a one-sided imposition of its culture on a struggling firm.

Emerging markets

Where Aberdeen really brought strength to the negotiating table was of course in Asia and emerging markets; it is still very much a leading player. Periodic downturns should be expected in emerging markets. Indeed, flows stated to return in the latter part of last year, so they may already be turning a corner.

The nagging concern is that since 2015 flows have predominantly been into



Martin Gilbert talks to Alastair O'Dell

passive funds while money continues to be taken out of active, according to EPFR Global data.

One reading is that flows into passive funds are signaling returning sentiment that will ultimately benefit Aberdeen. "It starts with taking shorts off, which happened last year. Then money goes into passive, then it goes into active," says Gilbert.

The third stage is the contentious bit. Investors, increasingly comfortable with passive, may no longer be convinced that active is appropriate in less efficient markets any more than it is in the US. There could be a ratcheting-down effect as each wave of money leaves active and reemerges in passive.

Nonetheless, Aberdeen reported inflows in the third calendar quarter of last year. "I thought we had turned the corner," says Gilbert. "Up until the Trump election sentiment was improving and money was coming back into emerging markets. But since then it's really been put on hold."

Gilbert is remarkably relaxed about the situation, perhaps because he knows President Trump personally, having played golf with him at his controversial course in Aberdeen. "I don't think he is protectionist... he [just] has an issue with people moving jobs offshore and big balance of payment surpluses with the US."

While "it's not great news" for emerging markets "it will be okay," he says. "If America sneezes, the world catches cold – but the opposite is true as well. We see good earnings growth, strong balance sheets and good economic growth. There is huge scope to outperform because they are so comparatively diverse and inefficient."

It has been an eventful decade for Gilbert; lauded when AuMs were peaking, Asia was roaring and for taking a commendably long-term approach – to facing persistent questions about outflows.


He could be forgiven for having some regrets, but that is not really in his character. "Quite the reverse. I think we are the victims of our success. We just grew so rapidly because of the emerging market cycle. We are going through tough times at the moment – but it's a result of previous success, not a result of anything we've done [wrong].

"[It's been] nothing compared to split caps, I can assure you. Nothing. 2002-2004 was really difficult. What makes or breaks you is how you deal with the tough times. You have got to really manage the business. I prefer the tough times actually."

In that case, he should enjoy the next couple of years. The integration of the businesses is a formidable task, although one for which Gilbert is ideally experienced.

The two firms complement each other and will provide useful cost savings – but the real challenge is arresting long-term AuM drift to passive funds and maintaining fee levels. In the final analysis, it is not the whole solution.

Gilbert remains as committed as ever to the cause, and one would not bet against further deals. "I'll keep working, I love it. I do not know how long I will do so but I have got to keep going. I always used Alex Ferguson [as an analogy], until he retired."

Whether he goes down in history like the legendary Manchester United manager, famed for building multiple winning teams over his 26-year tenure (or Arsene Wenger, who rigidly stuck to a strategy without ever recapturing Arsenal's golden era), will depend on what he achieves in the next chapter with Standard Life. 

ASSET MANAGEMENT: APPOINTMENTS

Jean Raby is to become the chief executive of **Natixis Global Asset Management (NGAM)**. Raby will take up the role later this month, succeeding Pierre Servant who will remain with the group. Raby previously worked at Goldman Sachs in Paris and became co-CEO of Goldman Sachs' activities in Russia back in 2011.

Meanwhile, **David Giunta** is to become NGAM's president and chief executive for the US and Canada, the firm announced this week. Giunta joined the company in 2008 after 14 years at Fidelity Investments.

Jeff McCarthy has joined **BNY Mellon** as chief executive of the firm's ETF business.

McCarthy joins from Nasdaq, where he was vice president and head of exchange traded product listings and trading. In this newly created role, he will report to Frank LaSalla, who leads BNY Mellon's global structured products and alternative investment services business. Before Nasdaq, McCarthy was head of global ETF products at Citi. Earlier in his career, he created Brown Brothers Harriman's ETF service model.



Jeff McCarthy

RBS International has appointed **Peter Brown** as head of funds, as part of the bank's wider strategy to serve its alternative funds customers in a more consistent way through a single business. Andrew McLaughlin, CEO of RBS International, stated: "There

is an increasing demand for specialist banking services to support the international alternative funds industry." Brown has been with the bank since 1997, most recently heading up the RBS Financial Institutions Group in the UK, which included the RBS funds banking business in London.

Invesco has appointed **Gareth Isaac** as chief investment officer, EMEA for Invesco Fixed Income (IFI). Based in London, Isaac reports to Rob Waldner, chief strategist and head of the multi-sector team for IFI. In the newly created role, Isaac will lead the portfolio management and strategic investment thinking of the global macro team in London, representing the EMEA region for the IFI investment strategy team. Isaac will support Nick Tolchard, IFI's head of EMEA. He will also work closely with the investment grade credit, high yield, emerging markets and credit analyst teams to assist product development.

NN Investment Partners has appointed **Adrie Heinsbroek, Faryda Lindeman** and **Johan van der Lugt** to the firm's newly established responsible investment team. They will drive the further development of responsible investing at NN IP and support all investment teams in their environmental, social and governance (ESG) integration and engagement activities. The team will report directly to Hans Stoter, chief investment officer at NN IP.

Chris Paine has joined **Schroders'** multi-asset investment team. He joins

from Henderson Global Investors. Paine will become a fund manager on the global income portfolio management team, which manages a suite of global income funds on behalf of its clients. He will report to Aymeric Forest, head of global income, multi-asset investments. Chris brings both an equity management background and quantitative analytical expertise. He will strengthen the team's research capabilities, as well as add to the oversight of security selection, asset allocation and portfolio construction.

The Investment Association has appointed **Peter Harrison** as chair. Harrison, the group chief executive of Schroders, will adopt the role from the start of May. Andrew Formica, chief executive of Henderson Group PLC, will become deputy chair. Both will both serve a two-year fixed terms as leaders of the Investment Association Board. It comes as the current chair, Helena Morrissey, will step down from the board as she joins Legal & General Investment Management, which already has an Investment Association representative.

Exchange-traded fund specialist **WisdomTree** has appointed **Altat Cassam** to a new role as head of European compliance. Cassam previously worked as a MiFID II consultant at Aberdeen Asset Management and has also held roles at Ernst & Young, Pioneer, Threadneedle and Natixis. He will be based in London and will be responsible for the entire European compliance

area, reporting to Bryan Governey, general counsel of WisdomTree in Europe.

Dutch asset manager **Robeco** has appointed **Peter Walsh** as head of its UK business. Walsh has been the firm's head of consultant relations since he joined the firm in 2014. He will retain that role until Robeco finds another consultant head. Walsh will lead the overall sales and marketing efforts for the Robeco UK office and will also have responsibility for the operational management for the UK.

M&G Investments has hired **Grant Hadland** to its equity and multi-asset businesses. Hadland was formerly a consultant relationship manager at Standard Life Investments and is also a former consultant relationships leader at Royal London Asset Management. In his new role, he is responsible for developing M&G's £58bn equity and multi-asset business' presence within the UK market, alongside Nick Robert-Nicoud who joined the firm 18 months ago.

Wells Fargo Asset Management (WFAM) has appointed **Nicolaas Marais** as president, with a broad range of responsibilities including multi-asset class solutions, research and product management. Marais will be based in both San Francisco and London and report to Kristi Mitchem, chief executive officer and head of WFAM. Marais was head of multi-asset investments and portfolio solutions at UK-based asset manager Schroders.

Most European markets already have their own central securities depositories (CSDs), critical market infrastructures that settle vast amounts of securities on behalf of investors. Ireland, however, is unique in that Irish securities currently settle in CREST, the UK-based CSD owned and operated by Brussels-based Euroclear since 2002.

Dublin officials now fear that under a so-called hard Brexit, which is looking increasingly likely, there is no guarantee that CREST would be granted equivalence under the EU's CSD Regulation (CSDR).

As a result, Ireland's stock market operator is in talks over its options for a CSD and settlement system for Irish securities. "We are engaged with the market, policymakers and partners on the options for a CSD and settlement system for Irish securities in a post-Brexit environment," an Irish Stock Exchange spokesperson told Global Investor in February.

Potentially, the plans could result in the creation of an entirely new Dublin-based CSD. Another route could lead Ireland to take advantage of the passporting rights under CSDR and settle Irish securities in an already established EU CSD.

The two major European CSDs Euroclear and Clearstream along with Irish Funds – the representative body for the international investment fund community in Ireland – declined to comment.

Sean Tuffy, senior vice president and head of regulatory intelligence at Brown Brothers Harriman, said Brexit has the potential to be "quite disruptive" in the usually sedate world of security settlements. "The disruption won't be in the UK, rather it would be felt across the Irish Sea in Dublin," he added.

More than 800 fund managers from over 50 countries have assets administered in Ireland. All but two of the top twenty global asset managers have Irish domiciled funds.

Under the EU's CSDR, one of the key regulations adopted in the aftermath of the 2008 financial crisis, a CSD must be authorised by a local EU member state regulator to carry out settlement functions.

"Since the UK will no longer be part of the EU post-Brexit, the question is whether this cross-border arrangement with Ireland will be allowed to continue when Brexit is all said and done," Tuffy said. "Meanwhile, EU policymakers want to make sure that, in the event of a hard Brexit, CSD equivalence isn't simply a backdoor into the EU market. Alternatively, Ireland could establish its own CSD."

Such a move by the Irish Stock Exchange could mean that

Ireland seeks new settlement

Ireland's stock market operator is looking at its options for a CSD in the post-Brexit world. *Andrew Neil* writes




Ireland chooses to connect to the European Central Bank's T2S (TARGET2-Securities) platform. T2S is designed to harmonise security settlements across Europe and provide centralised settlement in central bank money. It also eliminates the need for banks to hold collateral and liquidity buffers in silos across EU markets.

Euroclear Belgium, Euroclear France and Euroclear Nederland connected in September last year. Due to objections from UK policymakers, CREST is not participating.

Wave 4, the largest phase of the entire project, occurred in February and involved six CSDs, including Clearstream Frankfurt and LuxCSD, joining the platform. CSDs in Hungary, Slovenia, Slovakia and Austria also took part.

Delays have damaged faith in the project while connection costs have been high and transaction volumes well below what many had expected. However, February's migration means that that more than 80% of the European securities migrating to T2S now settle on the platform.

"This successful stage of the project puts to bed any concerns raised in Wave 4 market testing that caused some institutions to question the benefits T2S will deliver," said Tom Casteleyn, head of product management for custody, cash and FX at BNY Mellon.

"With most major CSDs now directly connected to T2S, it is time for the industry to focus on realising the settlement efficiencies and collateral management opportunities the new market infrastructure offers." 



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Waiting for the sun

Lebanon has remained in decent financial shape, despite political uncertainty and being cut off from major Gulf markets, and could experience a revival once Syria eventually starts to recover, says *James Gavin*

After two and a half years of political drift as the country failed to elect a president to succeed Michel Suleiman, who left office in May 2014, Lebanon is now showing signs of renewed economic vigour with a new head of state installed, a unity cabinet formed and promising indicators of improving investor sentiment.

The political compromise that saw the veteran former general Michel Aoun named president on 31 October 2016 has done much to reinject a sense of dynamism into a flagging economy. Real estate demand – one significant barometer of economic confidence in

Lebanon – spiked in the fourth quarter of 2016. Byblos Bank's Real Estate Demand Index showed a 17.5% increase in that period over the previous quarter.

"Toward the end of 2016, Lebanon witnessed a positive political development domestically that brought back a sense of confidence in the country's ability to boost its economic status. Lebanon elected a new president and succeeded in forming a new cabinet chaired by Prime Minister Saad Al-Hariri," says Mohamed Ali Beyhum, executive general manager at Lebanon's Bankmed and chairman and general manager of MedSecurities Investment Company.

The country's growth outlook has

improved markedly in the matter of a few months. The Washington-based Institute of International Finance projects Lebanon's real GDP growth rate to accelerate from an estimated 1.4% in 2016 to 3% in 2017, viewing the politically developments leading to a modest recovery in private investment and in exports of goods and services.

Michel Chikhani, managing director at BLOM Asset Management Co, cautions that it is too early to expect tangible signs of improved investor sentiment in the form of significant capital inflows. "But people are more aware now that there might be a possibility of an improvement," he says.



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Marwan Barakat, head of research at Lebanon's Bank Audi, is nonetheless confident that the political atmosphere will yield positive results. "On the basis of the domestic political settlement that led to successful presidential elections with regional international support, our macro forecast for 2017 rests on an improving growth scenario. We project growth at 4% in 2017, more than twice the average we had over past six years," he says.

Barakat foresees private investment growing by 15% in the next year, albeit from a low base in 2016. "For the past few years the Lebanese have been delaying investment decisions. Now, with the improvement in the political outlook, we at Audi are seeing more investment initiatives in the country," he says.

Reform agenda

There may be longer-lasting gains to be made. According to Bankmed's Beyhum, the long awaited political breakthrough is anticipated to pave the way for the much needed structural reforms and adjustments that would place the country on the right growth track for the coming years.

"The resumption of the domestic political process and the prospect of a government that is able to tackle Lebanon's reform agenda and set a budget to improve the country's infrastructure – particularly power, telecom, and transport – would have a material impact on confidence and growth. Hereby, the positive sentiment would boost inflows, support financial stability and promote investment," says Beyhum.

Last year saw a substantial growth in financial inflows into Lebanon, with a 40% increase in the first 11 months of 2016 to \$14.8bn.

The political changes have reinstated confidence in Lebanon's ability to recover and brought in a positive shift in the relationship with the Gulf states, especially with Saudi Arabia and Qatar. "This reconciliation with the Gulf is

expected to continue instigating activity within the tourism sector and would likely result in an improvement in investment. In fact, 2016 witnessed an upsurge in tourist arrivals, increasing 11.2%. Arab tourist arrivals, in particular, increased by 8.7%," says Beyhum, adding that the affluent Arab visitors are most sought-after and are no longer discouraged from take the trip by their home states.

Untapped potential

Although Lebanon has always attracted foreign private investments from the Gulf region, it still harbours a number of unexplored opportunities that remain untapped – in part because of the difficult politics surrounding Lebanon's confessional divide.

These barriers are being slowly dismantled. For instance, the long-term prospects in the knowledge sector are seen as very encouraging. "To help boost start-up investment, the Central Bank of Lebanon (BDL) issued Circular

331 through which it aimed to promote development of a local high-tech sector. The oil and gas sector also has a lot of potential, and once its policies and framework are set in place, this sector is likely to attract foreign investments,

especially from the GCC," says Beyhum.

"Finally, with discussions to start joint economic committees between Lebanon and Gulf nations in an aim to encourage trade and contribute to economic advancement, we tend to remain hopeful that the overall investment sentiment would improve."

Capital flows

Bank Audi's Barakat predicts that the resumption in Gulf investment flows and tourist numbers could lead to a 20% increase in financial inflows, generating \$10bn of additional deposits in the banking system. "We don't see much FDI at this stage. But we see more transfers, deposits and tourism receipts," he says.

Lebanon's capital markets should

see a continued boost from the political improvement. The Beirut Stock Exchange ended last year on a high note, with total trading value growing from \$500m to \$887m compared to the year before. In January 2017, total shares traded grew by 60.7% over the same month in January 2016, to 7.2 million, with value traded up by 21.7% to \$46.8m.

According to John Gebeily, head of MENA equities at Beirut-based Audi Capital, the Beirut stock market has always been considered a frontier MENA equity market – accounting for only 1.7% of the investable MENA universe and trading at a discount to peers considering the geopolitical regional risks. This makes it attractive to dividend-seeking investors, considering the yields on some of the larger listed socks.

"As core MENA suffers from high volatility, downside risks from oil and currency devolutions and emerging markets suffer capital outflows, peripheral frontier equity markets such as Lebanon and Jordan have seen more appetite from MENA equity investors over the past year," says Gebeily.

Infrastructure development

Investment managers see positive movements in the bond market too. "There's been a stabilisation of the credit default swaps, with the CDS spread dropping back from above 500 basis points (bps) to around the 400bps mark," says BLOM's Chikhani. "This has had a positive impact on the bond markets, which had been depressed. Now there's interest again and there are good opportunities for buyers."

Lebanon's capital market has the potential for further development, says the IMF, in its January 2017 Article IV assessment of Lebanon. The Capital Markets Authority (CMA) is now operational and a new trading platform is paving the way for market initiatives.

But the IMF warns that successful development will require a further strengthening of Lebanon's regulatory and institutional framework. As markets grow, the IMF urges the CMA to strike a balance between innovation and investor protection, shifting the nature of its oversight towards monitoring, risk-

"There's a solid custody and settlement process and an efficient market infrastructure in Lebanon that allows investment managers to operate"

MICHEL CHIKHANI, BLOM ASSET MANAGEMENT CO

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Custody & clearing

The Lebanese market has seen new rules on custody and clearing business, with the CMA publishing policies on clients' assets protection, account segregation and off balance sheet booking. The aim is to cut down on operational risk and improve quality and thereby build greater confidence in the market.

"There's a solid custody and settlement process and an efficient market infrastructure in Lebanon that allows investment managers to operate," says Chikhani, who heads up BLOM's wholly-owned asset management firm formed last year to manage and operate its portfolio of local and regional investment funds as well as segregated managed accounts.

Lebanon's asset management industry remains promising, Chikhani says. BLOM views it as a strategic business development opportunity locally and throughout the region, enabling it to offer products not only to retail clients but to institutional and high net worth investors. The aim, says Chikhani, is to offer differentiated products that are not currently available in the market.

"The asset management department was spun off from Blominvest in order to create a new asset management entity for BLOM in the region. We've also established in 2016 a new asset management company in Egypt, known as BLOM Financial Investments, and we've had a presence in Saudi Arabia since 2011"

Certificate of deposits

While investment managers will be keeping a keen eye on Lebanon, and the financial inflows are a positive indicator of future prospects, it is still too early to see large-scale portfolio repositioning towards Lebanon on the cards.

However, investor confidence is reaffirmed by BDL's financial swap arrangements conducted in mid-2016. Says Bankmed's Beyhum: "In May 2016, the BDL administered a financial operation in an aim to bolster its foreign

exchange reserves and commercial banks' capital buffers. As a basic step, BDL swapped Lebanese pound government debt for new Eurobonds with the Ministry of Finance.

"In June 2016, BDL encouraged domestic banks to purchase the newly-acquired Eurobonds and FX-denominated long-term certificates of deposit (CDs). In their turn, domestic banks were offered sizable incentives to participate in

the operation and were able to attract foreign currency deposits from outside the country."

This, explains Beyhum, enabled banks to recognise

a 3% increase in deposits between June and November 2016 to reach \$159.2bn as at end-November 2016. On a similar note, Lebanese banks also witnessed growth in their total assets, which increased by 5.5% between June and November 2016 to reach \$200.9bn as Lebanese commercial banks remain the chief source of funding to the economy.

The IMF cautions that with the operation now closed, inflows are projected to return to the levels seen in the early half of 2016 – short of the levels needed to fund the economy over the medium term.

The Syria situation

The other big challenge is what happens in Syria – inevitably a major influence on Lebanon. The Syrian crisis has smothered Lebanon's economic dynamism, slowing GDP growth from a pre-crisis average of about 10% in the 2007-2010 period to the low single figures. Investor confidence has been buffeted by Lebanon's proximity to the war-torn country, though security has, by and large, held up strongly since 2015. Still, Lebanese exporters have been prevented from selling goods via land-borne routes to the Gulf economies, losing them market share. The inflow of more than one million Syrian refugees has also been a heavy drain on limited resources, particularly infrastructure.

But despite the scale of the conflict

next door, there is hope for better news regarding Lebanon's relations with Syria. Citi, in a recent research note, said that the recent relative stabilisation of the situation in Syria could provide a more permanent and positive catalyst for political stability and sentiment in Lebanon. The stabilisation of security conditions in some areas of Syria constitutes a major economic opportunity for Lebanon through the

reconstruction and development efforts in these areas.

"A significant pick up in Lebanon's economy is highly contingent on developments in Syria," says Beyhum.

"Peripheral frontier equity markets such as Lebanon and Jordan have seen more appetite from MENA equity investors over the past year"

JOHN GEBEILY, AUDI CAPITAL

"In the event of a resolution to the Syrian war, Lebanon is expected to benefit from Syria's reconstruction, re-establish its trade routes, alleviate its fiscal pressures and current account deficit, consequently prompting the economy beyond its potential growth rate of 5%."

There are other incipient signs of improvements. The tourism sector has improved, and real estate, another weathervane sector, is also showing signs of life. Real estate transaction values rose by 8.8% in January 2017 compared to the same month in 2016, to \$570.8m. The government has provided funding support to the sector in the form of low-interest housing loans.

Longer-term, Lebanon is looking to capitalise on its prospective hydrocarbons resources. The government in early 2017 relaunched an offshore licensing round, offering five blocks for exploration, after two crucial decrees authorising exploration were shelved for more than three years. The country prequalified 46 international oil companies to investigate hydrocarbons prospects in 2013, including oil majors such as ExxonMobil. The chance of Lebanon becoming the latest East Mediterranean country to participate in the region's offshore oil and gas boom is tantalising, and would yield an immediate improvement in the country's balance of payments, though it must still be considered a long way from fruition. 

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Gaining currency

Foreign exchange prime brokerage in Asia is a huge growth market with demand outstripping supply, giving newcomers everything to play for.

Ceri Jones investigates

Foreign exchange (FX) prime brokerage in Asia is a major growth market. Demand has been driven to record levels by the boom in trading Asian currencies, especially on and off-shore renminbi, as well as bullion. There has also been a big shift in investment manager operations, which have increasingly moved from trading Asian currencies outside the region to local domiciles.

At the same time, tighter regulations requiring higher levels of minimum capital such as the Basel III liquidity coverage ratio (LCR) are drastically hiking the cost of capital for banks, especially in Hong Kong, Malaysia and Thailand. This, together with rising reporting and legal expenses related to operating in the space, has forced prime brokers to be stricter when allocating their capital.

"There has been a resurgence of sorts in the FX space, and the Asian markets are no exception," says John O'Hara, global head of FXPB and FX clearing, platform sales Asia, at Societe Generale. "In fact, with the increase in the number of fund managers located in Asia Pacific, it is arguably the region poised for the largest percentage growth globally over the next few years.

"As new funds are launched, the most effective way to gain access to liquidity is via a prime broker. However, with the provider resizing that has occurred and newly adopted, self-imposed restrictions on minimum account size, market entrants often find themselves struggling

to find a home."

Since these emerging managers often require services beyond the traditional FX PB offering – such as centralised clearing of select instruments, typically non-deliverable forwards – the list of viable partners diminishes even further. "A situation has developed where there is growing demand for FX PB and ancillary services in Asia Pacific and a shortage of providers able and willing to meet this demand," he adds.

Prime-of-prime

Escalating fees, regulatory capital and rising business costs have ensured that margins are slim, so scale is everything. Liquidity providers that offer both an international footprint and local know-how can pick and choose their clients. Brokers have also been quick to grow their market shares through the prime-of-prime model, offering micro contract trades, often with leverage, and credit services to smaller firms unable to

access FX prime brokers directly. Some smaller hedge funds and asset managers make do with mini-prime and cloud providers, another sector that is growing at speed.

ADS Securities launched its FX prime





“With the increase in the number of fund managers located in Asia Pacific, it is arguably the region poised for the largest percentage growth globally”

JOHN O'HARA, SOCIETE GENERALE

new and exciting channel,” says Louisa Kwok, head of prime of prime sales at ADS.

“Uncertainty in western financial markets, as a result of Brexit in the UK and the new President in the US, is driving many traders to put a greater percentage of their business into Asian markets. We see growing interest in opportunities in Asia and the need for Asian institutions to trade in their domestic currencies via NDFs.”

The cost to trade these local instruments and currencies, which are lower in volume than most G10 currencies, is often higher, and they are less accessible, so Asian firms need to look for partners that are able to leverage their capitalisation to offer greater access to liquidity providers, and at preferential rates, according to Kwok.

“We saw this especially towards the back end of 2016 with increased emerging market volumes in particular in Asia with Tokyo, Hong Kong and Singapore capturing most of London’s loss in volume. Globally, as tier one prime brokers continue to focus their efforts on selected large brokers, ADS has been able to fill the gap for middle-tiered clients that alone have lost a lot of their PB options, as well as clients who

are looking to access additional lines,” says Kwok.

“Clients in Asia have shared the same experience, so it made sense to expand our prime offering. For clients in Asia we have increased our currency scope and laid foundations to ensure easier access for clients to setup their targeted liquidity providers.”

Exits and entrants

The shortage of capacity in Asia has also been exacerbated by a number of exits. European providers in particular have been forced to retrench and refocus their efforts on domestic markets as a result of higher operating and financing costs through uncleared margin. The exit of Rabobank in 2014 was instrumental in opening up the lower end of the market as, although the Dutch bank offered direct credit lines to the interbank FX market, it also serviced the middle market of less well capitalised firms that the major providers ignored.

One newcomer making headway is CFH Clearing. “Having offices in Hong Kong and Tokyo is key,” says James Dewdney, institutional sales, based in Hong Kong. “It is important to be able to operate within the Asian time zone and to have team members who speak the local language and understand the business culture. It marks our commitment to the region to be able to invite clients to our offices or visit them for face-to-face meetings. In many cases, meaningful relationships cannot be forged solely on the telephone – this is arguably more pronounced in Asia compared to the West.”

“Active, sophisticated FX clients in Asia are aware that London is the capital of global foreign exchange and that London-based data centres boast the busiest and most liquid trading centres,” he adds. “They are also aware that the FCA provides one of the most respected regulatory frameworks in the world. This creates a huge opportunity for CFH – as

of prime brokerage offering in August last year and claims “tremendous interest from clients in Asia”, primarily from retail brokers, and traditional and quant funds. “For firms that need access to high quality liquidity, prime-of-prime offers a

CUSTODY & FUND SERVICES: FOREIGN EXCHANGE

we have a point of presence in the key datacentres and are authorised and regulated by the FCA.”

Stater Global Markets, an FX prime of prime brokerage established in London last October 2016 by CEO Ramy Soliman, began marketing its services in the region at its first trade show – a Hong Kong-based event – in February 2017, and has taken on Wei Xu, a native Chinese speaker, with experience in the Asian market, in the role of operations manager.

“With the increase in prominence of Asian hubs such as Singapore and Hong Kong for global FX trading, we see an underserved institutional market in addition to a well-established retail investing community very familiar with FX and bullion,” says Soliman. “The region also acts as an excellent conduit to the Chinese market, which has significantly increased in sophistication. As reforms make the yuan a more significant global reserve currency this will further increase the regional importance of the Asian market.”

“Unlike in other regions, many professional and institutional traders have not historically had much access to prime-of-prime services that can offer them direct market access liquidity aligned to institutional-standard technology and service from a top tier jurisdiction. We believe 2017 will be a year when specialisation will be key. Professional traders that may be trading elsewhere will gravitate towards institutional services.”

Trading technology

For asset managers, the incidence of black-swan events in recent months has highlighted the importance of stable, executable price liquidity, and improved price discovery. Technology and platform quality is also a critical differentiator. Some of the newcomers have been able to build integrated platforms, offering clients a single interface from day one.

“With a limited number of proficient

FXPBs and FX clearers in Asia Pacific jurisdictions, there is a particularly large bottleneck for managers seeking to employ their strategies and put investor money to work since there are fewer firms with which they can partner,” explains Stephen Woodrow, platform sales Asia at Societe General. “This is increasingly frustrating for portfolio

managers as volatility continues to increase and they have been unable to capitalise on it. Undoubtedly, this frustration, once adequately vocalised, will draw the attention of those seeking to secure a foothold in the region – early mover advantages clearly exist.”

Raymond Mok, head of FX and bullion development, Sucden

Financial (HK) Limited, agrees: “Clients are becoming increasingly sophisticated, requiring not only good pricing and liquidity, but also new technology, comprehensive risk management tools and customised trading solutions. Those that are able to stay ahead of the curve will make a positive impact on all the stakeholders.”

CFH has developed a portfolio of proprietary technology.

“Our focus remains on providing clients with the correct tools to be profitable and grow – whether this takes the form of assisting our clients with adherence to regulation, profitability of their B-book, liquidity optimisation, hosting/connectivity in data centres or white labelling options,” says Dewdney. “We will continue to market to sub-regions in Asia and have ambitious growth plans in the region.”

While China is plugging holes in its foreign exchange rules to keep its currency and reserves from sinking below key levels, the trend among governments in general has been to become more liberal.

“In South East Asia, local regulators are

gradually easing the control on foreign exchange and our customers see this as a tremendous opportunity to distribute the liquidity to their customer base,” explains Pierre Perras, product manager for FX cash on FusionCapital at Misys. “The challenge is around always being able to find a reliable source of liquidity given the regulatory constraints.”

“Infrastructure in Asia is not as mature as in the American and European market place, but liquidity is getting stronger and Asia has been catching up over the last five years. That is why some FX players are still relying on European prime-of-prime to address clearing and liquidity challenges in the Asia Pacific region.”

FX ecosystem services provider FXecosystem has instigated a new network operating centre (NOC) and engineering facility in Asia to help FX trading firms in the region maintain service and reliability levels.

“FXecosystem’s expansion in Asia has been driven by demand from our European and American institutional and local retail FX clients wanting to access the better infrastructure and connectivity in Asia,” says James Banister, CEO. “To service this growing demand we have invested heavily in our global network to offer our clients ultra-low latency network

connectivity. Our headquarters in Singapore and points of presence in Singapore and Hong Kong

underpin our expansion in the region.”

The company’s Meet-Me-Room enables clients to have a single point of entry to connect to FX participants. Banks and brokers trading across Asia, London, New York, can use it to connect over 70 different venues. The roundtrip delivery time between London and Singapore is 187ms, the company says.

“There is a disconnect between the blistering growth occurring in Asia Pacific and FXPB’s ability to keep pace,” adds OHara. “It is doubtful that this mismatch will persist indefinitely as providers shift their attention from regulatory imposed distractions and get back to the business of doing business.”

“Unlike in other regions, many professional and institutional traders have not historically had much access to prime-of-prime services”

RAMY SOLIMAN, STATER GLOBAL MARKETS

“For firms that need access to high quality liquidity, prime-of-prime offers a new and exciting channel”

LOUISA KWOK, ADS SECURITIES

Blockchain: hype or real?

By Tomoaki Sako, General Manager, Settlement and Clearing Services Department, Mizuho Bank Ltd

It's been a while since blockchain and distributed ledger technology (DLT) became buzzwords in the financial industry. I clearly remember that, on the very first day of SIBOS 2015 in Singapore, a thousand people rushed into a conference room with the capacity for fewer than 300 to see the panel discussion on much-hyped blockchain technology. Our proof-of-concept trial on DLT with support from Fujitsu also dates back to the summer of 2015.

The domestic backdrop

Certain percentages of inbound cross-border yen instructions fail to settle on the initially planned value date. By contrast, pure domestic trades of Japanese securities between residents of Japan seldom fail. So how can we reduce settlement failures even when we receive settlement instructions from non-resident clients? Our proof-of-concept trial was designed to address this issue.

Let's start with the reason why securities settlements fail. Unlike cash, securities only settle when instructions sent by the buyer and seller match. If either party to the trade puts incorrect information in its instruction, the instructions do not match and the trades fail to settle. Most settlement failures are caused by such unmatched instructions. Another major cause of settlement failures is insufficient balance, but these are generally triggered by a preceding settlement failure caused by unmatched instructions.

This leads to our theory – if there are no unmatched instructions, there would be no settlement failures. The securities post-trade system for domestic trades in Japan (and also similar domestic systems

in other jurisdictions) proves that theory. In domestic trades, trade matching results are systematically shared by all the parties involved in the post-trade process. For CCP-cleared JGBs and equities settled through JASDEC (Japan Securities Depository Center), settlement instructions are automatically generated from the trade-matching results. Therefore, instructions always match, and settlements almost never fail. Why 'almost' never? When a domestic trade fails to settle this is generally due to an insufficient balance, caused by a preceding settlement failure of a cross-border trade triggered by unmatched instructions.

Cross-border trades

Cross-border trades are also first matched to confirm the trade. However, there is no system to share matching results on a global basis as that would require a gigantic data center. Therefore, buyers and sellers independently generate settlement instructions based on the trade matching result, and pass it over to the next party in the post-trade loop through messaging systems all the way to Japan. To maintain the consistency of instructions, throughout past 20 years enormous efforts have been made to set the global standard for settlement instructions and achieve a high straight-through-processing (STP) rate. We have all made sizable investments in post-trade systems. Nevertheless, settlement failures are not down to zero.

The assumptions we made for the purpose of trial were: (1) we could globally share trade information over DLT without setting up a huge centralised system, as DLT allows parties to share information in


a tamper-proof form over a P2P network; and (2) with such a settlement support system, we could reduce settlement failures of cross-border trades.

Demo system

Based on our idea, Fujitsu first designed and developed a demo system over the Bitcoin blockchain. Our idea was to use DLT only for the purpose of sharing information useful to parties in different jurisdictions.

As the local agent bank carries out actual day-to-day operations, we needed to be realistic. Therefore, we presumed the holding balance of securities are made final in the same way as under the existing legal framework. Further, we also presumed the use of the existing settlement infrastructures, including our own system and the systems of our clients, to the extent that was possible. This approach may look conservative but, based on our actual experiences and issues that we face daily as an agent bank, we still see significant possibilities in this system to enable non-residents to shorten the time required for cross-border post-trade and overcome time differences.

Going forward

Mizuho and Fujitsu were invited to speak about our trial at the first and third FinTech Forums hosted by the Bank of Japan. The proof-of-concept trial is now in the fourth phase, and we are testing it over different DLT platforms for comparison to analyse the features of each platform. Assessment of the compatibility and suitability with the business requirements in post-trade services would be an inevitable step to make this technology real. 

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CUSTODY & FUND SERVICES APPOINTMENTS

BNY Mellon has appointed **Stephen Doyle** to the newly created role of head of UK institutional relationship development for asset servicing. Based in London, Doyle will report to Ileana Sodani, head of relationship development for asset servicing for EMEA. In his new role, Doyle will work with asset servicing solutions across the investment lifecycle, focusing on asset owners and traditional asset management clients, the firm said. Doyle was previously at Societe Generale Securities Services, which he joined in September 2015 as head of institutional sales for the UK and Ireland. Before this, he served as senior sales vice president at Northern Trust for just over one year.



Claudine Gallagher

Claudine Gallagher has been chosen to lead **BNP Paribas Securities Services** across the entire Americas region. The former JPMorgan executive joined the French bank in 2012 and has been a key figure behind the firm's US expansion. She now takes charge of existing operations in the US, Brazil, Colombia and Peru. Alvaro Camuñas previously led the unit's Latin America business. He was named global head of sales and relationship management last year. Andrea Cattáneo and Claudia Calderón –

country heads of Brazil and Colombia – now report directly to Gallagher.

Standard Chartered has appointed **Colin Brooks** as vice chairman of its securities services and transaction banking business. Based in Singapore, he will report to Margaret Harwood-Jones, the bank's global head of securities services and transaction banking. Brooks has 26 years of experience across the Asian markets and began his custody career at HSBC in 1990 as part of a small team that created the firm's securities services division. He went on to hold key senior positions in HSBC's securities services business, most recently global head of custody & clearing – a role which he held for seven years.

Societe Generale's custody unit has set up a new business solutions team, with 15 people already in eight locations in Europe and more hires to follow. Ex-State Street vice president **Matthew Davey** has been appointed as managing director and head of business solutions, effective immediately. The newly created team reflects the bank's aim to reinforce its service offering for institutional investors, asset managers, financial intermediaries and corporates, SGSS said in a statement. In his newly created role, Davey will be based in Paris and will report to Christophe Baurand, global head of coverage, market and solutions.

Luxembourg-headquartered service provider **Kneip** has appointed **Gary Janaway** as its new chief operating

officer. Effective 1 January, he is responsible for operations and IT. Previously Lee Godfrey, Kneip's new CEO as of January, was managing operations and IT directly as deputy CEO. Janaway joins from Schroders. He was had been with the firm since 1991, most recently serving as director of operations in the Luxembourg office. His responsibilities at Schroders included distribution support, fund administration, fund performance, investment risk, project management, product implementation, treasury and cash management, and transfer agency services.

Former RBC executive **Tim Wood** is taking charge of **HSBC's** UK securities services business. The move, disclosed in an internal memo seen by *Global Investor*, will see Wood take over responsibility for the UK division from Rafael Moral Santiago. Santiago remains in charge HSBC's wider European securities services operation overall. The appointment comes after *Global Investor* revealed **London-based Wood** had left his role at RBC Investor & Treasury Services in early January.

State Street has appointed **John Plansky** as global head of its Global Exchange business. Plansky will be responsible for global strategy, new product development and developing solutions for clients to manage complex data, focus on attracting assets and meet further risk challenges. Based in Boston, he will report to Lou Maiuri, head of Global Markets and Global Exchange. Plansky joins from

PwC. Since April 2014, he has led the US strategy and US global platforms divisions. Before this role, he was a senior partner at Booz & Co, prior to the acquisition by PwC, where he headed the technology practice.

Deutsche Bank has appointed **Mahesh Kini** as head of global transaction banking (GTB) for China. In his new role, Kini will be responsible for the bank's China-based GTB businesses including investor services, issuer services and institutional cash management. Kini joined Deutsche Bank in 2007 as managing director and regional head for cash management corporates at Asia Pacific. Since September 2016, he has been managing director and head of global transaction banking and head of trade finance and cash management for China. Earlier in his career Kini had spells at HSBC and Bank of America.

CIBC Mellon has appointed former State Street and Citi employee **Michael Garneau** to an executive role in its relationship management team. In his new role, Garneau is responsible for managing client relationships and supporting continued growth in the Quebec region. He will also provide client service for pension, investment fund, insurance, corporate and other Canadian institutional investors based in Quebec. Prior to joining CIBC Mellon, Garneau worked with Citibank Canada from 2013 to 2016. Garneau spent nearly 20 years as vice president for Eastern Canada, institutional investor services, at State Street Trust Company Canada.

Mexico set for SBL boost

An upcoming Mexican trading venue taking on incumbent bourse BMV believes it can add supply to the country's securities lending market.
Andrew Neil investigates

BIVA, short for Bolsa Institucional de Valores, has been in the works four years now but is set to launch later in 2017 and operate a full fledged stock exchange, subject to regulatory approvals. The company plans to leverage the assets of its holding company, Cencor, which runs an interdealer broker business, fair-value price provider, institutional broker and securities lending platform, MEI.

In a note to clients in February, analysts at broker ITG pointed out that sceptics question whether a new exchange is warranted, given that 12 securities were responsible for trading more than 50% of 2016 volumes in Mexico.

However, BIVA's executives point to that fact that four pension funds have backed the project with a 450 million pesos (\$22m) investment through a private equity firm, which demonstrates investors' appetite for an additional, competing venue.

Technology

The new exchange also signed a deal with Nasdaq X-Stream two years ago, meaning it has a technological edge to attract market participants and strengthen adjacent areas, including securities lending.

"Competition is the right way to go," Rodrigo Velasco, BIVA's director of operations, told *Global Investor*. "Although Mexico's fixed income market is deep and liquid, our equity market continues to lag behind. This spills over to securities lending, which works pretty well in Mexico, but hasn't seen enough development in terms of supply and demand on the equity side."

Part of the problem, Velasco admits, is that only a handful of hedge funds are based in the country. Most are domiciled outside of Mexico and do business in the US.

"Right now we're working with institutional investors, brokers, banks and regulators who are very open to sensible market adjustments which would create a level playing field similar to what clients are used to in the US. Crucially, we want to create a flexible securities lending environment, not a restrictive one."

Upon BIVA's launch, firms will be able to trade on both existing bourse BMV – still the second largest stock exchange in Latin America with a total market capitalisation of over



\$530bn – and BIVA. Clearing and settlement will continue to be through the Contraparte Central de Valores (CVV).

Meanwhile, firms already trading on BMV bourse have the option to change their primary listing to BIVA once the new venue is up and running. In terms of asset classes, BIVA's initial focus on the cash equity market; derivatives will be explored at a later date.

Velasco adds that the group is talking to the Latin American Private Equity & Venture Capital Association to steer some of the country's alternative assets to the public market. "Mexican authorities have made it easier for companies to list," he adds. "Requirements have been lowered. That's been a positive step."

The country now faces headwinds this year from three fronts – local politics, the economy and international trade. "Access to the equity markets via the national exchange Bolsa de Valores has been another challenge," analysts at ITG added in their note last week.

"While the economy and international trade are being affected by a new US administration led by Donald Trump, the BMV's issues lie within its own infrastructure. Delayed market data or bandwidth during rebalances forced the BMV to close its doors to investors four times in 2016 while it dealt with the outages. This has highlighted the need for a new exchange for competition." Ⓞ

"Securities lending... works pretty well in Mexico, but hasn't seen enough development in terms of supply and demand on the equity side"

RODRIGO VELASCO, BIVA

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Rocky road of reporting

Alexander Westphal of the International Capital Market Association warns that SFTR is likely to be just as problematic for repo and securities lending as the introduction of EMIR was for derivatives



There are growing concerns about the health of the European repo market. Latest signs of stress in the market materialised around year-end 2016, which saw significant volatility and dislocations with banks effectively closing their books for repo business. A recent ICMA report assessed the reasons for these events and not surprisingly found regulation among the key contributing factors.

However, it is not only participants in repo trades, both sell- and buy-side, who are feeling the pressure from regulation. The repo back office is facing important challenges too. Most importantly, the push from regulators to shed light on the so-called shadow banking system has led to an increased focus on securities financing transactions (SFTs), including repo and securities lending.

SFTR

In Europe, this resulted in the adoption of the EU SFT Regulation (SFTR) which, among other things, is set to introduce extensive regulatory reporting rules. While the law itself entered into force in early 2016, the details of the reporting rules are still being hammered out by ESMA, the EU securities authority. ESMA's final technical proposals are expected to be submitted to the Commission by the end of March.

What is already clear is that successful implementation will require banks and all other users of the European repo market to rethink the way repos are processed. According to the latest ESMA proposals, market participants will need to report over 70 data fields on each of their repo trades. This would cover information on the counterparty, the details of the loan as well as extensive information on the collateral component.

On top of this there will be additional fields related to the reporting of margining and collateral re-use, a particularly controversial element of the regime. In line with the reporting framework for derivatives introduced by EMIR, the SFTR requires double-sided reporting. Both reports have to be submitted to specifically authorised trade repositories (TRs), which are expected to pair and match them, both intra- and across TRs. Regulators expect most of the 70-odd fields to match with only very limited tolerance allowed. There are doubts whether this is a realistic approach given that firms

themselves currently only capture a small proportion of the data fields required by the SFTR.

Lessons from EMIR

The experience with EMIR is not encouraging. Matching rates have been dismal from the start and have in many scenarios still not reached meaningful levels. SFTR includes some improvements over EMIR, in particular related to the standardised ISO20022 format or additional guidance on unique trade identifiers. However, the implementation challenges remain substantial and the time until expected go-live of the reporting, in late 2018, is limited.

Reducing the number of both reporting and matching fields, at least at the outset, would help. This could be done for instance if the rules would leave it to TRs or regulators to derive parts of the information from available central sources for static data, e.g. using reported ISIN codes to retrieve information related to securities collateral. Not only would this lower the implementation burden for firms, but it would also reduce the scope for data inconsistencies and thus make it easier for regulators to use the data for supervisory purposes. In its latest consultation response to ESMA, the ICMA ERCC has made a number of concrete proposals to achieve this.

Another hope lies with third-party vendors. Some solutions are starting to emerge and coalitions to form. This includes platforms for the automatic matching and affirmation of repo trades prior to reporting, but also more comprehensive front-to-back solutions that help to enrich and complete reports based on static data sources. Whether these can be translated into viable products that can be delivered in time for the SFTR go-live remains to be seen. Close collaboration between the industry and the relevant vendors will certainly be a critical success factor.

There is a chance that the regulatory pressure in relation to reporting can be ultimately translated into a more efficient and automated post-trade process for repo. However, it currently seems unlikely that this will be a much shorter and less rocky road than the one taken under EMIR. ☹

Alexander Westphal, is director, market practice and regulatory policy, of the International Capital Market Association (ICMA)

The pace of SFTR preparation has picked up. Conversations around the regulation both at industry events and with our clients have shifted from the fundamentals of the regulation to the technical challenges that need to be addressed to meet the approaching compliance deadline. With Pirum Systems recently combining forces with IHS Markit to jointly develop an end-to-end reporting solution we view the technical challenges as falling into five main categories: data gathering, standardisation, reconciliation, reporting and connectivity.

Our partnership will address these areas by offering a fully hosted, modular solution that deals with every aspect of the reporting process from gathering trading and collateral data to delegated reporting to trade repositories.

Data Gathering

SFTR reporting regulation is, at its core, a data gathering exercise. This is further complicated by the fact that the complex and fragmented nature of the securities lending and repo market is such that no one platform holds a complete view of all the data that has to be reported. Rationalising the data workflow will involve numerous third parties for some of the industry's larger participants.

Any vendor or industry participant looking to tackle SFTR reporting should first focus their attention on how to gather the complete data set across the entire spectrum of trades that must be reported.

The rapidly approaching deadline (currently Q3 2018) coupled with scarce IT resources make this a daunting task and the industry is now looking to expedite the data roundup by leveraging existing industry data pipes.

Finding a way to funnel trading data into a single stream is only half the challenge. Many of the 140+ data fields mentioned on the level 2 draft such as collateral maturity dates and issuer credit ratings sit outside the scope of many of these platforms.

The roadmap to SFTR implementation

Therefore, the data gathering exercise will have to include enrichment from externally sourced reference data and third parties, which adds to the difficulty of the task ahead. Counterparty Legal Entity Identifiers (LEIs) is another key data field that has not been present in industry data reporting previously and will bring its own complex set of technical challenges.

Standardisation

The data that is gathered needs to adhere to a common standard to meet the high levels of matching requirements and minimal tolerances dictated by ESMA. These standards, which cover such issues as naming conventions and decimal rounding, may seem trivial at first, but stitching together trading activity without them becomes nigh on impossible.

Much like data gathering, industry participants can alleviate this issue by setting out clear standards and guidelines long before implementation so these

variables don't impede progress further down the line.

Reconciliation

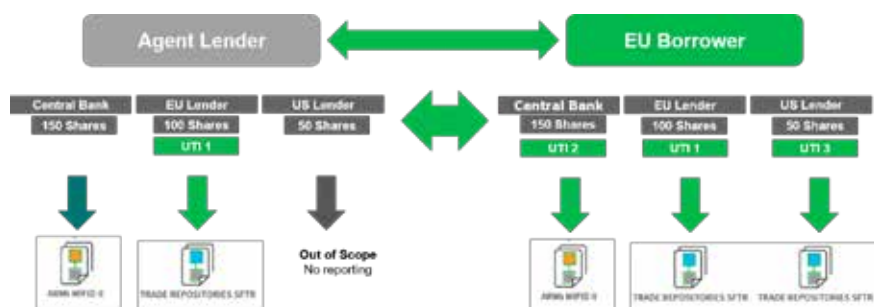
Only when the industry's data has been marshaled, cleansed and normalised can the process most commonly associated with SFTR, creating Unique Trade Identifiers (UTIs), begin.

Our belief is that the UTIs will typically be created in the post-trade reconciliation when both sides of the transaction have been received and

matched. As this is the first point at which all the necessary data points are combined, generating UTIs at this stage ensures all transactions are captured, covering trades made on or off platform, corporate action outturns and lender allocations. Creating the UTI as a part of the reconciliation will ensure the UTIs are generated at the correct level and that both sides will receive the same UTI for a single transaction.

If UTIs have been successfully allocated earlier in the process, for example at novation to a CCP or point





of booking on a trading platform, these will be fed into the reconciliation and maintained, with new UTIs generated for all transactions that don't already have one.

The generation of UTIs is only half the battle. Once generated UTIs have to be propagated to both trading counterparties to adhere to the two-sided reporting requirements. The connectivity needed to ensure this flow of information occurs on a timely and efficient basis is arguably the largest, and entirely new challenge faced by the industry as no one tool or solution currently offers it.

Reporting

Once trades have been reconciled and assigned their UTIs, the industry will then have to determine which need to be reported to the trade repositories. Although SFTR is primarily a two-sided reporting requirement in nature there is likely to be a significant amount of one-sided reporting. When an EU based borrower find themselves facing off to a non-EU beneficial owner (BO) in an agency lending trade, the borrower must still report the transaction including the LEI of the out of scope BO. This creates a dependency on the lender providing information on each allocation, regardless of whether the BO for each allocation is in scope.

Furthermore, the overarching MiFID II rules, which are set to go live in January of 2018, play a role in deciding which

loans are reported. A central bank for example must still report their trades that fall under MiFID to an Approved Reporting Mechanism (ARM) but the securities finance trades are exempt from SFTR which further adds to the reporting challenge.

The data architecture and rules based engine utilised by the Pirum & Markit solution will have the flexibility to meet your transparency and risk reporting requirements both now and in the future as further SFT reporting regimes come into force in other jurisdictions.

Connectivity

SFTR reporting will require a large amount of post trade connectivity and lifecycle monitoring to flag up events such as partial recalls, collateral substitutions and trade termination. In fact, new trades make up less than a third of the change events that fall under the scope of SFTR according to an analysis of the Markit Securities Finance database.

With market price and loan value information part of the required dataset, both data points will change daily for the vast majority of transactions so it's not unreasonable to

assume that every transaction will need to be modified on a daily basis post the initial report. Add this to the mix of other post-trade events such as re-rates, re-allocations and partial terminations and it becomes apparent that a single reportable transaction will come with a significant amount of subsequent

reporting obligations. This highlights that anyone looking to tackle the reporting challenge ought to place as much importance on post-trade connectivity as they do on identifying new trades.

Conclusion

Reporting go-live is now expected to start in Q3 2018 rather than Q1. You could infer that this six-month delay suggests that the governing body ESMA realises just how difficult and complicated a task SFTR is for the securities finance industry. Market participants and vendors wait with baited breath to analyse the final regulatory technical standards expected to be released at the end of March 2017.

Changes to some of the challenges present in the consultation paper in September 2016, including value date collateral reporting, reporting of margin loans, execution timestamps, and a high number of matching fields with low tolerances, will be on the wish list of many market participants.

Even with the implementation delay, we strongly suggest that firms do not pause for a collective breath but rather ensure they are employing a strategic and holistic approach to their regulatory roadmap over the next five years. Firms should consider what is in place now (EMIR), what is coming up shortly (MiFID II) and what is on the near horizon (SFTR).

Furthermore, the regulations once in play don't stay static and there is likely to be frequent change and moving parts with updated technical standards being released regularly. If the process is managed in a robust fashion, the overall challenge will be easier leaving participants to focus on alpha generation areas and overall service to their clients.

Pirum & IHS Markit believe that our modular approach offers the most comprehensive way to meet the many different challenges posed by the regulation covering all reportable SFTs. Together, we believe we are on the right track to work collaboratively with the industry to lead the way towards a solution that will meet the needs of participants and regulators. 🌐

For more information on our SFTR solution please contact SFTR@pirum.com or SFTR@ihsmarkit.com

Liquidity liberation

IMF economist Manmohan Singh's research shows that securities lending will receive a boost from the normalisation of monetary policy, writes *Alastair O'Dell*

Central bank quantitative easing continues in the Bank of Japan and ECB but the Fed has surely reached its peak and ultimately all central bank balance sheets will be unwound. For now, balances remain measured in trillions of dollars globally, including \$4.5trn at the Fed. The question for market participants is how this will play out for securities lending when the time comes.

Dr Manmohan Singh, senior economist, International Monetary Fund (IMF) said that the unwinding of quantitative easing would alleviate pressure on broker-dealer balance sheets and boost securities lending.

"If central bank balance sheets are unwound, the flipside is that banks will get balance sheet space. If banks get balance sheet space then some businesses – including securities lending – would get a chance to do more in the financial system," he told the IMN US Beneficial Owners Conference. "If central banks change tack and securities do not get rolled over you will start to see [bank] balance sheet space appear a lot faster [than expected]. This can help collateral become a lot more fluid."

He said that there is evidence from recent significant sales of Treasuries by emerging market central banks that the market can absorb sales of assets currently locked away in silos. "Central bank balance sheet unwinding gives space and helps the dealer community accommodate a lot more transactions that they are not willing to do right now."

There has of course been an



expansion of AAA securities "but much of these securities has been silo-ed" on central bank balance sheets so "they have no velocity". This is a problem because "AAA lubricates the other collateral to move" in the collateral upgrade chain.

"Once collateral is with the market, it moves"

MANMOHAN SINGH, IMF

happening outside their balance sheets. Until recently they were the fulcrum... now central banks have taken a lot of good securities."

Collateral velocity

He noted that the levels of pledged collateral (reusable, with title transfer) in the 15 largest banks has decreased since the financial crisis and remains much lower for half a decade, from around \$10trn to \$5.65trn in 2015 and, at the moment, "they are not bouncing back".

"Less AAA leads to less efficiency and ease of pricing" of all other types of collateral. "Once collateral is with the

market, it moves."

Since a seminal Reserve Bank of Australia paper investigating the velocity, or reuse, of collateral there has been many studies into its significance for the functioning of markets. A recent CGFS paper identified that collateral reuse and rehypothecation is decreasing.


Singh said that velocity had decreased from three at the time of the Lehman crisis to below two now. "Collateral is coming in – but it is not being circulated in the way it used to be."

When it ends up at the central bank "it's a closed loop". "The money printed takes balance sheet space – trillions of space. If that space is unclogged, you would have space at the banks which would allow them to do other activities. Whether those securities come out and what it means for securities lending is huge."

Central clearing

However, the central clearing of OTC derivatives provides an avenue for the central bank to accumulate more deposits that could also become silo-ed. BIS figures, he said, suggest that a huge new wave of collateral is set to reach central bank balance sheets.

"If CCPs do their jobs, where will all these deposits [margins] go? Where will the \$2-3trn go? CCPs are allowed to deposit at central banks at privileged rate, in the US 75bps at the Fed."

"If trillions bypasses the plumbing and goes directly to the Fed, where is the money to price the plumbing? I believe it is better done at the market level... The more that goes to the balance sheet of the public sector the rustier the plumbing becomes – the signals are not as deep and liquid." 

Coping with constraints

Securities finance experts gathered in New York in mid-February to try to find a way for the business to function under increasingly demanding regulation. *Andrew Neil* reports

An industry-wide effort to find ways of connecting lenders and borrowers on favorable terms has become a top priority for the securities finance market this year. Reduced balance sheet capacity, primarily caused by regulation, has resulted in large broker-dealers being far more sensitive to the types of securities, collateral and counterparties involved when they borrow.

Agent lenders conducting business on behalf of beneficial owners face their own pressures, meaning these typical types of lending and borrowing intermediaries have limited capacity to service securities finance market activity to the levels they once did.

“Every dealer will be looking at their own set of binding constraints, be it the net stable funding ratio (NSFR) or risk weighted assets (RWAs),” said Duncan Foster, managing director at Morgan Stanley, speaking at an RMA event in New York last month hosted by law firm Debevoise & Plimpton. “The industry needs a set of collegial solutions in order to get 90% of the way towards efficient borrowing and lending for all counterparties as opposed to searching for a panacea for everything.”

Central counterparty clearing houses (CCPs), such as Eurex in Europe and OCC in the US, are building new models to satisfy both sides of a securities finance trade. Meanwhile collateral flexibility and term trades are being used more frequently by lenders to match what the borrowers are looking for and meet evolving demands.

Deutsche Bank’s Tony Toscano –



another panelist at the RMA event – said anything that will help save capital will be welcomed by both the agent lenders due to the cost of indemnity, as well as borrowing community for capital they have to set aside. However, he suggested that broker-dealers currently hold most of the cards and the market takes time to adapt.

“Business will ebb and flow in 2017 depending what large broker-dealers need. Securities lending desks will have to adapt,” Toscano added. “That could mean facing off with different legal entities or changing collateral structures to pledge rather than rehypothecation.”

Alex Blanchard, head of US repo at Goldman Sachs, stressed the importance of informing clients on the current restrictions faced by traditional market participants. “Balance sheet has become an allocated rather than a priced resource. Educating customers and beneficial owners on whether they are going to pay a lot of costs or generate higher returns through larger transactions is the bigger point,” he said.

Another panelist at the event, representing the agency lending


business of a major US bank, said that alternative ways of connecting lenders and borrowers are starting to appeal. “Clearly there is demand for high-quality liquid assets (HQLA) and many beneficial owners have supply. New bilateral structures are starting to generate more interest,” the individual said in the discussion.

Following the event, a report by Aite Group suggested that participants in the securities lending market will need to move toward a more streamlined

electronic infrastructure that will provide interoperability across jurisdictions if the sector is to grow. Aite Group’s study, titled Securities Lending 101, concludes that although there have been some attempts to provide a true electronic order book, none have gained “dominant market share”.

“Liquidity is fragmented across beneficial owners lending directly and agent lending programmes. Often, pools of lendable securities are not optimised within large firms operating multiple divisions,” said Bill Butterfield, senior analyst at Aite and one of the report’s authors.

“Deals are often consummated via phone, email and chat. For the sector to grow, firms will need to move toward a more streamlined electronic infrastructure that will provide interoperability across jurisdictions.”

Butterfield and his colleagues also suggest that consolidation in the vendor space might breed better collaboration and movement toward electronic marketplaces and CCPs, as there are fewer players to consider in a consortium. 

Strength in numbers

One year ago, Deutsche Borse, one of the world's largest institutional trading networks, decided to align its trading, clearing and custody activities much closer across its various legal entities, including Eurex Repo, Eurex Clearing and Clearstream global securities financing.

Philippe Seyll, Co-CEO of Clearstream, part of the Deutsche Borse group, sat down with *Global Investor* during the Deutsche Borse Global Funding and Financing Summit in Luxembourg.

"Despite the fact that those services are conducted in separate legal entities, our new internal set up allows us to align much closer when facing customers," said Seyll. "One of our major achievements is that we now have aligned product teams, client facing teams and business environment, cutting across all the different businesses."

"This is more of a mental shift within the firm in order to facilitate the way in which we are perceived from the outside, showing clients the different trading, clearing and settlement layers at once."

Through the repurchase programme from the European Central Bank (ECB), liquidity is increasingly being withdrawn from the market, resulting in the plummet in interest rates to record low levels. Some financial products therefore, including these repurchase agreements, are suffering.

"The second major success that we have been able to achieve is that three national central banks – Deutsche Bundesbank, the Bank of Italy and the Bank of Latvia – decided to use Deutsche Borse as their sole partner for their PSPP programme," Seyll stated. "Through these cooperations, we act as the lending arm of two major central banks in Europe."

Under Eurex Repo, Clearstream introduced a further number of products that aim to provide the buy-side with access to cleared solutions. "Another initiative that we came up with is the

Philippe Seyll, co-CEO of Clearstream, speaks to *Merle Crichton* about the upcoming challenges for CSDs



Philippe Seyll

lending programme through a central counterparty clearing house (CCP). Deutsche Borse was the first player in the market to come up with this safe securities lending process and at the moment we can see how this programme is gaining traction."

Liquidity and ledger

Jointly with a group of other central securities depositories (CSDs), Deutsche Borse created a platform for CSDs to collaborate on collateral management. Liquidity Alliance grants members the opportunity to exchange information, identify common needs and extend global collateral solutions.

"We are a group coming from different regions of the world and thereby bring together a unique pool of global insight and expertise," Seyll said. "To date, the Liquidity Alliance consists of eight member from various countries worldwide. We embrace open architecture and are therefore looking forward to welcoming new members in the future."

Four members of the Liquidity Alliance – Clearstream, the Canadian Depository for Securities (CDS), South Africa's


Strate and Norway's VPS – are currently cooperating with Deutsche Borse to launch an initiative leveraging blockchain technology to ease cross-border mobilisation of security collateral. The planned solutions aims at overcoming existing hurdles when moving collateral across various jurisdictions, making the transfer faster and more efficient.

CSDR

The aim of CSDR is to harmonise certain aspects of the settlement cycle and settlement discipline and to provide a set of common requirements for CSDs operating securities settlement systems across the EU, according to the European Securities and Markets Authority (ESMA).

"All the current and upcoming changes in regulation put a lot of pressure on market participants in order to comply," said Seyll. "CSDR has ramifications both for us as CSDs and our customers. But once implemented, CSDR will help to make sure that customer assets are held in an extremely safe manner across Europe, and it will help to lower structural risk in the financial markets of tomorrow. We have to comply by 2018 – so there are still two years to prepare."

CSDR is first and foremost about settlement efficiency, according to Seyll. It intends to ensure that CSDs are not only regulated, requiring them to "fulfil certain standards", but also that they collateralise credits with their clients.

"We are already complying with most of the CSDR regulation today. But we need to take into account all processes and business areas impacted by this regulation. We are therefore reviewing our operations to determine if, where and how we need to adjust our practices in order to comply. It's heavy lifting." 

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BENEFICIAL OWNERS SPECIAL REPORT 2017

**Beneficial owners survey & US roundtable
discussion, sponsored by DataLend**

Maximum benefits

The highest average scores belonged to Goldman Sachs, unweighted, and JPMorgan, weighted, while State Street took a significant share of the regional prizes in the *Global Investor* survey, supported by DataLend. Analysis by *Alastair O'Dell*

The *Global Investor* 2017 survey of beneficial owners' views about their agent lenders' performance produced the same global winners as last year but behind the headline results there were many interesting developments.

The all lenders tables – where responses relating to all types of lending arrangements are included – are based on all 139 responses to the survey. The winner of the weighted table was JPMorgan, which it also achieved last year. It did so through consistently strong performance across all the regions. However, the winning scores in the Americas and Asia Pacific belonged to State Street while Citi again triumphed in EMEA.

On the unweighted side of the survey, the all lenders tables contained less change compared to last year. Goldman Sachs Agency Lending repeated its performance of 2016 by achieving the highest average score and highest scores in EMEA and the Americas. JPMorgan again had the highest total global score. The only change was that State Street triumphed in Asia Pacific, raising its position from runner-up last year.

Across the survey the results were tight. This is perhaps unsurprising given the widespread satisfaction expressed by the survey respondents: 84.1% were either extremely or very satisfied with their programmes (see *survey respondents box page 9*). The winning average scores have also crept up since 2016 – unweighted by 0.03 and weighted by 0.05.

It must also be remembered that the providers rated in this survey represent the best performing ones in the market – reaching the target number of responses and having a strong international presence are minimum requirements. Qualifying for the survey is an achievement in itself – even firms positioned towards lower in the tables can feel justly proud.

JPMorgan

JPMorgan was the winner of the beneficial owner survey using the weighted methodology, where the respondent's AuM and the aggregate importance they attach to each service category is taken into consideration (see *methodology page 10*). It achieved both the highest average score and the highest global total.

It achieved this by performing strongly in all three regions, EMEA, the Americas and Asia Pacific, achieving runner-up spot in every one. The gaps to first place were very tight: 0.03 for EMEA, 0.02 for Americas. JPMorgan improved its 2016 weighted scores in every region, so also in total and on average.

Under the unweighted methodology it also achieved the highest global score. It received a very creditable third-place average score, replicated in EMEA and the Americas (where its score was an improvement on 2016).

JPMorgan excelled in a wide variety of service categories. Weighted, it took the top spot for seven. The top three in descending order were risk management, collateral management and settlement & responsiveness to recalls. It was second in two and third in

the remaining three. Unweighted, it was second place in three and third in four.

When only responses from those engaged in custodial lending arrangements were taken into account, JPMorgan fared even better – it was the global winner, in terms of average and total scores under both the weighted and unweighted methodologies. Weighted, it was the winner in the Americas and unweighted it was the winner in EMEA and the Americas.

In the corresponding service categories, JPMorgan was the winner in eight weighted service categories and eight unweighted service categories (the same ones).

One respondent in the Americas that only used JPMorgan stated that “due to their size and scale, they are able to customise products that meet our needs” while another that it “brings unique opportunities to us”. Another appreciated its depth of knowledge: “Of the two we use JPM is much more proactive and brings more market insight, wider range of expertise to the table – other agent lenders aren't as proactive or responsive.”

Also in the Americas a beneficial owner stated: “JPM has provided us direct access to a highly professional team of traders, collateral managers, credit, compliance as well as customer relationship personnel many of which have been actively servicing our account for more than ten years. This level of stability and familiarity is a huge value-add that is not adequately captured in the metrics. They are a top notch agent lender in our opinion.”

In EMEA, JPMorgan “continues



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**Goldman
Sachs**

BENEFICIAL OWNERS SURVEY 2017

to look at areas to achieve greater yields,” according to one beneficial owner, while another stated it “created transparency in dealing with urgent reputational risk issues”.

A respondent in EMEA gave an insight into how its adds value: “JPMorgan endeavours to offer new products and types of trades to improve returns

as well as offering a suite of reporting that enhances clients’ internal MIS [management information system]. With regulations changing and future changes being considered, JPM’s dedicated relationship managers facilitate direct meetings with subject matter experts as well as technology/reporting to ensure their clients are compliant.”

JPMorgan was considered to be the most innovate agent lender by the joint highest number of respondents in Asia Pacific, where it also secured the most votes in 2016. One respondent in the region was particularly impressed: “We are very satisfied with the service JPMorgan offer. Their service is very reliable and high quality. I can feel enthusiastic.” While another noted “this agent wins the high revenues”.

Another Asia Pacific respondent listed its attributes: “High revenue performance, relentless efforts to increase earnings, efficient and sophisticated reporting, great customer support system, kind and excellent personnel.” Another praised its “trading efficiencies, new generation reports and lending market expansion.”

Goldman Sachs Agency Lending

Goldman Sachs Agency Lending (GSAL) achieved the highest unweighted average score, repeating its 2016 performance. It also again received the highest unweighted scores in the regions for which it qualified, EMEA and the Americas. It therefore also received the highest global total among firms that qualified in two of the three regions.

In the weighted tables GSAL achieved

the second-highest average score, impressively halving the margin to first place achieved in 2016. It did so as a result of consistency: it received the third-highest score in EMEA and the Americas.

In the unweighted service categories, GSAL took the top spot for nine categories including its highest winning scores (in descending order): collateral management, handling of corporate actions/dividends, developed market coverage, settlement and responsiveness to recalls, programme customisation, emerging market coverage, provision of market and regulatory updates, Risk management, and income generated versus expectation.

It had its highest score for relationship management, but was overtaken to first place. It took second spot for three categories.

In the weighted service categories, it received the top score for reporting and transparency as well as second place for seven others and third place for the remaining four.

GSAL improved its unweighted score in the Americas above the level it achieved in 2016. Weighted, the improvement was much more significant – it improved its scores in every region it qualified for so also on average and in total.

In the third-party agency lending tables GSAL was the overwhelming winner, as it was in 2016. It was the highest-rated provider in EMEA and the Americas (no firms qualified in Asia Pacific) and therefore had the highest global total

and average. It was a clean sweep for both the unweighted and weighted methodologies.

As one would expect from the headline third-party tables, GSAL did extremely well in the corresponding service categories. It was the winner of nine unweighted categories (second for the remaining three) and all 12 weighted categories.

In EMEA a beneficial owners stated: “GSAL anticipates our needs and always collaborates on new products and trades. It also develops tailor-made reporting tools for more transparency on market activity... We integrated lending into collateral management/optimisation and GSAL supported us.”

Another beneficial owner in EMEA benchmarked a few agent lenders in order to assess the services it was being provided with by GSAL: “It was the best provider in many areas and we maintained our relationship given the outcome of the review.”

Also in the region, one commented: “Excellent service provided on the whole, especially during volatile climates as a result of Brexit and US elections, we were kept informed by our contacts on a regular basis.”

A respondent in the Americas stated: “GSAL offers consistently high and effective engagement from its relationship management team. It demonstrates an excellent control environment in relation to both the application of unique programme parameters and in preparation of customised reporting. GSAL also provides industry thought leadership

ALL LENDERS (WEIGHTED)					
COMPANY	EMEA	AMERICAS	ASIA PACIFIC	GLOBAL TOTAL	AVERAGE
Citi	6.59	5.72	X	12.31	6.16
Deutsche Agency Lending	6.18	5.24	X	11.42	5.71
eSecLending	5.51	5.89	X	11.40	5.70
Goldman Sachs Agency Lending	6.28	7.02	X	13.30	6.65
JPMorgan	6.56	7.47	6.17	20.20	6.73
RBC Investor & Treasury Services	5.39	5.33	X	10.72	5.36
State Street	6.00	7.49	6.30	19.79	6.60

ALL LENDERS (UNWEIGHTED)					
COMPANY	EMEA	AMERICAS	ASIA PACIFIC	GLOBAL TOTAL	AVERAGE
Citi	6.24	6.30	X	12.54	6.27
Deutsche Agency Lending	6.59	6.37	X	12.96	6.48
eSecLending	6.73	6.61	X	13.34	6.67
Goldman Sachs Agency Lending	6.82	6.71	X	13.53	6.77
JPMorgan	6.63	6.38	6.71	19.72	6.57
RBC Investor & Treasury Services	6.32	6.26	X	12.58	6.29
State Street	6.58	6.30	6.81	19.69	6.56

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BENEFICIAL OWNERS SURVEY 2017

and superior technical knowledge at all levels, and consistently outperforms both benchmarks and other agent lenders.”

Another in the region applauded its “excellent client service and operational management.”

State Street

State Street was by far the most improved agent lender in this year’s

survey. It has always been a strong performer but this year it broke into winning positions in the all lenders regional tables. Indeed, it was the most improved agent lender in every region, and therefore globally and on average, in both the weighted and unweighted tables.

It was also voted to be the most innovative provider globally.

State Street achieved particularly strong results when the scores were weighted for category importance and respondents’ lendable portfolio. It was the winner in two regions: Americas and Asia Pacific. It also achieved third place for global average and second for total score.

In the unweighted tables, State Street took the top spot in Asia Pacific. It also had the second highest global total.

In the weighted service categories, State Street had the winning score in four areas: income generated versus expectation, programme customisation, provision of market and regulatory updates, and relationship management. It was second-placed in three and third-placed in the remaining five. This also represents a significant improvement on 2016.

In the equivalent unweighted tables, its best positions were second places in three areas: engagement on corporate action opportunities, programme customisation, provision of market and regulatory updates.

When only responses relating to custodial lending programmes were considered State Street received very strong scores. For both weighted and unweighted, it took the runner up spot for average score (and global total). It also took first place in Asia Pacific and second place in the Americas under both methodologies. It also took second place in EMEA unweighted (third

ALL LENDERS SERVICE CATEGORIES (WEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED VS EXPECTATION	LENDING PROGRAMME PARAMETER MANAGEMENT
Citi	7.12	4.14	7.34	5.81
Deutsche Agency Lending	6.65	3.47	7.11	5.15
eSecLending	X	X	7.24	5.60
Goldman Sachs Agency Lending	8.41	4.56	8.59	6.40
JPMorgan	8.52	4.68	8.48	6.70
RBC Investor & Treasury Services	6.77	X	6.83	5.10
State Street	8.42	4.60	8.67	6.22

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Citi	3.63	2.63	5.02	3.27
Deutsche Agency Lending	3.24	2.13	4.51	3.05
eSecLending	X	X	4.71	3.19
Goldman Sachs Agency Lending	4.01	2.74	5.54	3.84
JPMorgan	4.21	2.83	5.48	3.93
RBC Investor & Treasury Services	2.92	X	X	3.11
State Street	4.09	2.66	5.69	3.94

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Citi	6.56	7.47	10.50	7.19
Deutsche Agency Lending	6.29	7.19	9.70	6.63
eSecLending	6.48	7.59	10.10	6.99
Goldman Sachs Agency Lending	7.48	8.75	11.83	8.29
JPMorgan	7.46	8.69	12.23	8.43
RBC Investor & Treasury Services	5.89	6.96	9.83	X
State Street	7.66	8.57	11.68	8.08

ALL LENDERS SERVICE CATEGORIES (UNWEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED	LENDING PROGRAMME PARAMETER MANAGEMENT
Citi	6.22	6.56	5.90	6.47
Deutsche Agency Lending	6.50	6.24	6.32	6.40
eSecLending	X	X	6.33	6.83
Goldman Sachs Agency Lending	6.93	6.88	6.50	6.75
JPMorgan	6.72	6.67	6.17	6.68
RBC Investor & Treasury Services	6.64	X	6.07	6.29
State Street	6.71	6.69	6.32	6.32

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Citi	6.50	6.40	6.53	6.06
Deutsche Agency Lending	6.48	6.19	6.44	6.33
eSecLending	X	X	6.67	6.50
Goldman Sachs Agency Lending	6.88	6.73	6.75	6.69
JPMorgan	6.84	6.65	6.39	6.53
RBC Investor & Treasury Services	5.93	X	X	6.40
State Street	6.78	6.35	6.68	6.63

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Citi	6.45	6.05	6.30	6.30
Deutsche Agency Lending	6.84	6.52	6.44	6.44
eSecLending	7.00	6.75	6.58	6.67
Goldman Sachs Agency Lending	6.94	6.69	6.69	6.88
JPMorgan	6.58	6.32	6.53	6.58
RBC Investor & Treasury Services	6.43	6.29	6.57	X
State Street	6.79	6.26	6.32	6.42

weighted). Again, a significant improvement.

In the custodial lender service category tables State Street was the winner in four categories, was the runner up in a further seven and third in the final one.

In the equivalent unweighted tables it was the winner of four categories and the runner up in five and third in a further two.

A beneficial owner based in the Americas applauded State Street for “introducing new lending solutions” and a different one its “lending cash to closed-end funds utilising sec lending proceeds”.

Several respondents appreciated its handle on regulatory change. One stated: “State Street provides necessary reporting, quickly addresses change and offers product alternatives. They are always quick to provide information on regulatory topics – even possible changes”. Another one commented: “They have a very good understanding of the regulatory challenges faced by the securities lending industry and opportunities available to exploit.”

In EMEA a beneficial owner stated: “Very good and established agency lender, had a turnaround in staff last six to eight months [and is] now back on track.”

In Asia Pacific beneficial owners commented: “Proactive in exploring transaction opportunities to maximise the yield”, “Very satisfied with their client service and commitment”, and “We are

Most innovative

The following providers received the largest number of votes from beneficial owners in the most innovative agent lender category:

- **Global winner:** State Street
- **Americas:** Deutsche Bank Agency Lending
- **EMEA:** RBC Investor & Treasury Services
- **Asia Pacific:** State Street, JPMorgan (jointly)

Most improved

The most improved agent lender is the one that increased its weighted score by the greatest margin over its 2016 score. **State Street** was the most improved in every region and globally for both weighted and unweighted.

very satisfied with the service State Street offer this year. Their services are very reliable and high quality. I can feel enthusiastic, energetic and positive about them.”

State Street was judged to be the most innovative agent lender by the largest number of beneficial owners around the world.

One respondent in EMEA commented: “I have seen innovations in new product offerings from State Street that other competitors do not currently offer and solutions to issues that some of their clients currently face, which other providers do not have” Another concurred: “They are bringing us new ideas.”

It was also the joint-winner of the most innovative category in Asia Pacific. One beneficial owner in the region praised its “enhanced indemnification for cash collateral management, proactive in exploring opportunities in the market to maximise yield for client’s portfolio, data transparency as well as client engagement and relationship management.”

“State Street has been proactive to come up with innovative ways to increase security lending income for our account,” commented an Americas respondent. Another stated: “They suggested a new structured lending product with an attractive lending income.”

Citi

The 2017 survey produced a varied set of scores for Citi – it had some great scores in certain areas such as custodial programmes in EMEA and third-party ones in the Americas, in both cases particularly so from large lendable portfolio beneficial owners.

Citi’s standout performance was with large beneficial owners in EMEA, where it was the highest-rated firm under the weighted methodology. It is a title it also won in 2016. Its best global service category table position was emerging market coverage, unweighted.

Citi improved its weighted scores in both of the regions where it qualified, so also improved on average and in total.

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In EMEA a beneficial owner commended it for “exploring new lending markets and thinking along with clients [how] to increase revenues”. Another highlighted its technology: “Quant model/software to extract maximum value out of assets”.

It was also the winner in EMEA, weighted, when only custodial lending programme responses were considered. Respondents commented that it “significantly outperforms the other agents” and “thinks along with clients

how to increase revenues and create new opportunities.”

Among custodial programme respondents, weighted, it also was the third-highest rated firm in the Americas. Its EMEA and Americas scores secured it third position for global average.

In the unweighted custodial lender tables it was third for the two regions for which it qualified, as well as global average and total.

In the weighted custodial lender service category tables it had a solid

performance across the board. It took the runner up spot for emerging market coverage and third-placed for the remaining 11 categories. In the equivalent unweighted category tables it was the runner up for lending programme parameter management and took the third place spots for six categories.

When it came to third-party agent lender programmes, its performance in the Americas secured the runner-up spot weighted and third-place unweighted.

In the Americas one respondent

that now uses only Citi stated it “has significantly increased the amount of our securities out on loan” while another stated “they have been able to provide consistent income.” A further one added: “They offered some options for cash reinvest with money market reform – their systems ensure that we are maximising the revenue potential for the funds.”

Beyond purely financial aspects, others praised its other attributes: “Citi is very informative and provides tremendous personal service”, “Thinking outside the box in order to get loans out to market” and “customising the programme to meet our conservative guidelines.”

Because it only qualified in one third-party region it was not eligible for consideration in the related service category tables.

eSecLending

eSecLending performed very strongly in the unweighted

CUSTODIAL LENDERS (WEIGHTED)

COMPANY	EMEA	AMERICAS	ASIA PACIFIC	GLOBAL TOTAL	AVERAGE
Citi	6.89	6.00	X	12.89	6.45
JPMorgan	6.88	7.51	6.17	20.56	6.85
RBC Investor & Treasury Services	5.39	5.33	X	10.72	5.36
State Street	6.00	7.49	6.30	19.79	6.60

CUSTODIAL LENDERS (UNWEIGHTED)

COMPANY	EMEA	AMERICAS	ASIA PACIFIC	GLOBAL TOTAL	AVERAGE
Citi	6.35	6.28	X	12.63	6.32
JPMorgan	6.82	6.53	6.71	20.06	6.69
RBC Investor & Treasury Services	6.32	6.26	X	12.58	6.29
State Street	6.58	6.30	6.81	19.69	6.56

CUSTODIAL LENDERS SERVICE CATEGORIES (WEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED VS EXPECTATION	LENDING PROGRAMME PARAMETER MANAGEMENT
Citi	7.40	4.00	8.00	6.11
JPMorgan	8.51	4.77	8.64	6.72
RBC Investor & Treasury Services	6.77	3.67	6.83	5.10
State Street	8.42	4.60	8.67	6.22

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Citi	3.83	2.69	5.22	3.52
JPMorgan	4.24	2.90	5.46	3.92
RBC Investor & Treasury Services	2.92	2.02	4.41	3.11
State Street	4.09	2.66	5.69	3.94

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Citi	7.08	8.17	11.34	7.59
JPMorgan	7.53	9.01	12.48	8.71
RBC Investor & Treasury Services	5.89	6.96	9.83	6.51
State Street	7.66	8.57	11.68	8.08

CUSTODIAL LENDERS SERVICE CATEGORIES (UNWEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED VS EXPECTATION	LENDING PROGRAMME PARAMETER MANAGEMENT
Citi	6.08	5.91	6.08	6.42
JPMorgan	6.80	6.87	6.31	6.75
RBC Investor & Treasury Services	6.64	6.31	6.07	6.29
State Street	6.71	6.69	6.32	6.32

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Citi	6.55	6.30	6.42	6.09
JPMorgan	6.94	6.80	6.38	6.56
RBC Investor & Treasury Services	5.93	5.85	6.38	6.40
State Street	6.78	6.35	6.68	6.63

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Citi	6.58	6.25	6.42	6.25
JPMorgan	6.69	6.63	6.75	6.88
RBC Investor & Treasury Services	6.43	6.29	6.57	6.23
State Street	6.79	6.26	6.32	6.42

tables. The clients that provided responses may have had smaller lendable portfolios but they were certainly impressed by its performance. It took the runner-up spot for global average, a result built on its second-places in EMEA and the Americas.

Indeed, SecLending improved on all of its unweighted scores on its 2016 results – in every region so also in total and on average.

Likewise, in the unweighted service categories it was a strong performer. It was the winner of three categories (in descending order): relationship management, lending programme parameter management, and reporting and transparency. It was runner-up for a further three categories and third-placed in one.

For third-party agent lending programmes it again performed best unweighted. It was the runner-up in terms of global average and total as well as for EMEA and the Americas. Weighted, it came in third-place across the board.

In the unweighted service categories it was again the winner of the three same categories. It was also in second position for the remaining nine. Weighted, it was runner-up in all 12 categories.

A theme among respondents was that eSecLending was full of ideas. “They are constantly searching for value and new opportunities,” stated one in EMEA, while others in the region commented “eSecLending is proactive, exploring new emerging markets” and “they are always approaching us with new trade

ideas and possibilities”.

A beneficial owner in the Americas commended its “nimbleness, and outside the box thinking. They constantly provide what we need and always look at various trades even if they are never executed.”

Others in the region commented that “eSecLending has been innovative with unique funding scenarios and with their auction process” and that it has “solid customer service, reporting and transparency are excellent.”

A respondent in EMEA singled out the CEO: “In the three years since Craig Starble took over, eSecLending has continued to deliver across its product range. The lending agent has a clear vision of their future and is completely client-led. No other agent lender has been able to offer us such a bespoke and high quality service.”

Deutsche Agency Lending

Deutsche Agency Lending was considered the most innovative agent lender by the largest number of beneficial owners in the Americas.

One respondent in the region that uses Deutsche as its sole provider commented that “they have been innovative in managing through discussions around government fund vs. floating NAV cash collateral products.” Another stated “they have solutions to difficult problems.”

Deutsche Agency Lending’s best performance was for its third-party agency lending product, particularly among larger clients. Weighted, it

achieved the runner-up position for its global average and total scores.

“Proactive in working with other custodians to ensure maximum effectiveness of the programme,” commented one Americas respondent.

Its best region for third-party weighted scores was its home market of EMEA, where it attained second place.

Unweighted, it achieved third-place for EMEA and on average and total.

In the all lender tables it improved its weighted score in EMEA and unweighted score in the Americas over its 2016 scores.

One beneficial owner in EMEA praised its “forward-looking handling of German equity transactions”. Another commented: “We are very satisfied with the services of Deutsche Agency Lending. The London team is very responsive and professional.”

Other highlights were third-place finishes for the unweighted all lenders service categories of relationship management, reporting transparency, and income generated versus expectation (jointly).

Several beneficial owners in the Americas were full of praise: “Deutsche has been an excellent provider for us. Their staff is one of the best,” commented one, “excellent earnings generated in a risk-managed environment,” stated another, while a further one was “very happy with them so far!”

One respondent in the Americas appreciated its “great customer service and problem solving, great securities lending programme,” while another said

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that “Deutsche Agency Lending has been a great partner from programme implementation through present-day. They have exceeded our earnings expectations as well as our relationship and customer service expectations. We appreciate their ability to customise our programme to our needs and real-time reporting. We look forward to working with them for years to come.”

RBC Investor & Treasury Services


RBC Investor & Treasury Services (I&TS) was judged to be the most innovative provider by the largest number of beneficial owners in EMEA. One respondent in the region noted its “well-

controlled operating infrastructure... and comprehensive web-based reporting system”. Another commended its “adaptation to change and proactivity in servicing the fund when new regulatory requirements occur” while another simply stated “we have a very proactive relationship with RBC”.

RBC I&TS performed best relative to its peers when only custodial lending arrangements were considered. It had several areas of strong performance. Unweighted, it achieved the runner-up spot for risk management, reporting and transparency and programme customisation (jointly).

Respondents in the Americas

commended its “great reporting, low fail rate and recalls for proxy voting” and “knowledge and experience with the programme.”

RBC I&TS had its highest service category position for risk management, unweighted. In the Americas one stated: “RBC provides us with a competitive product that is well managed and generates supplemental income for next to no risk. Our major plan sponsors are comfortable with RBC’s product and its execution.” In EMEA a respondent commented: “RBC Investor & Treasury Services guarantees a stable and sustainable service, as well an open mind to what’s coming in the future.” 

THIRD-PARTY AGENT LENDERS (WEIGHTED)

COMPANY	EMEA	AMERICAS	GLOBAL TOTAL	AVERAGE
Citi	X	6.03	X	X
Deutsche Agency Lending	6.18	5.24	11.42	5.71
eSecLending	5.51	5.89	11.40	5.70
Goldman Sachs Agency Lending	6.28	7.02	13.30	6.65

THIRD-PARTY AGENT LENDERS (UNWEIGHTED)

COMPANY	EMEA	AMERICAS	GLOBAL TOTAL	AVERAGE
Citi	X	6.39	X	X
Deutsche Agency Lending	6.59	6.37	12.96	6.48
eSecLending	6.73	6.61	13.34	6.67
Goldman Sachs Agency Lending	6.82	6.71	13.53	6.77

THIRD-PARTY AGENT LENDERS SERVICE CATEGORIES (WEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED VS EXPECTATION	LENDING PROGRAMME PARAMETER MANAGEMENT
Deutsche Agency Lending	6.65	3.31	7.11	5.15
eSecLending	7.21	4.02	7.24	5.60
Goldman Sachs Agency Lending	8.41	4.56	8.59	6.40

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Deutsche Agency Lending	3.24	2.03	4.51	3.05
eSecLending	3.42	2.36	4.71	3.19
Goldman Sachs Agency Lending	4.01	2.74	5.54	3.84

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Deutsche Agency Lending	6.29	7.19	9.70	6.63
eSecLending	6.48	7.59	10.10	6.99
Goldman Sachs Agency Lending	7.48	8.75	11.83	8.29

THIRD-PARTY AGENT LENDERS SERVICE CATEGORIES (UNWEIGHTED)

COMPANY	COLLATERAL MANAGEMENT	HANDLING OF CORPORATE ACTIONS/DIVIDENDS	INCOME GENERATED VS EXPECTATION	LENDING PROGRAMME PARAMETER MANAGEMENT
Deutsche Agency Lending	6.50	5.95	6.32	6.40
eSecLending	6.80	6.82	6.33	6.83
Goldman Sachs Agency Lending	6.93	6.88	6.50	6.75

COMPANY	DEVELOPED MARKET COVERAGE	EMERGING MARKET COVERAGE	PROGRAMME CUSTOMISATION	PROVISION OF MARKET AND REGULATORY UPDATES
Deutsche Agency Lending	6.48	5.91	6.44	6.33
eSecLending	6.64	6.55	6.67	6.50
Goldman Sachs Agency Lending	6.88	6.73	6.75	6.69

COMPANY	RELATIONSHIP MANAGEMENT	REPORTING AND TRANSPARENCY	RISK MANAGEMENT	SETTLEMENT AND RESPONSIVENESS TO RECALLS
Deutsche Agency Lending	6.84	6.52	6.44	6.44
eSecLending	7.00	6.75	6.58	6.67
Goldman Sachs Agency Lending	6.94	6.69	6.69	6.88

SURVEY RESPONDENTS

Global Investor invited beneficial owners of all types to rate their agent lenders across 12 service categories (see below). The largest group of respondents was asset managers/mutual funds, representing 46%. The other significant groups were, in descending order: public pension funds, insurance companies, private pension funds, central banks, corporations, sovereign wealth funds and endowment funds.

Respondents were asked how many agent lenders they used. The clear majority use a single provider (68.7%) followed by two (21.4%), three (6.9%), five, (1.5%) and more than ten (also 1.5%).

Almost half (46.8%) had a total AuM greater than \$50bn. There was a uniform distribution of portfolio sizes right down to \$1bn although there was a sizable peak in the \$10-15bn bracket, accounting for 11.5% (most \$5bn-wide brackets represented approximately 5%).

Likewise, respondents were asked the total approximate value of their portfolio that is available to be lent. Numbers were smaller here (necessarily) but 25.2% of respondents still stated their available balance was larger than \$50bn.

Respondents were asked the approximate value of the assets that are typically out on loan at any point in time. These figures were much lower – none had more than \$35bn on loan and 69.1% had balances of \$2bn or less.

Beneficial owners were asked how satisfied they were with the returns on their lending programmes. The results here were very encouraging for the industry with widespread satisfaction: 38.1% were extremely satisfied; 46% were very satisfied; and 15.1% were moderately satisfied. Only a single beneficial owner was slightly satisfied and none were not satisfied at all.

Respondents were asked about the types of collateral they accept into their programmes. The most accepted forms of non-cash collateral were: sovereign debt 24.7%; equities 11.6%; corporate debt (financials) 9.09%; corporate debt (ex-financials) 8.2%; letters of credit 2.2%; convertible bonds 2.0%; and other 3.1%.

Respondents were also asked about the currencies they accepted for cash collateral. USD was the most popular at

24.7%; followed by euros 6.8%, sterling 4.3%, yen 1.1%, Australian dollars 1.1%, Swiss francs 0.6% and other 0.3%.

The respondents were asked about what influenced their choice of agent lender. For just over half (51.8%) the provider's credit rating was extremely important. For 41.7% it was very important and for the remaining 5% it was moderately important.

Programme indemnification is one of the most discussed topics last year and will remain so. Regulation has made it more expensive for agent lenders to provide indemnification, as capital must be allocated against it being offered. It is becoming increasingly common for agents to offer different fee splits for indemnified and non-indemnified programmes and it may be the case that they offer indemnification to certain clients and not others.

The respondents were asked how they would react if indemnification was no longer offered as part of the programme. 59.6% stated that they would close their programme. 9.9% stated that they would continue without indemnification. The remaining 30.4% stated that they would pay for indemnification.

Respondents were asked whether they started programmes with any new agent lenders in the last 12 months: 10.1% had added provider(s) and 89.9% had not.

Respondents were asked the importance that they attach to each of the 12 service categories. The respondents ranked the categories from 1 (most important) to 12 (least important). All rankings from around the world were then averaged and used in the process to create the weighted tables.

• Risk management	2.38
• Income generated versus expectation	4.5
• Reporting and transparency	4.72
• Collateral management	4.84
• Settlement & responsiveness to recalls	5.03
• Relationship management	5.83
• Lending programme parameter management	6.33
• Programme customisation	7.06
• Engagement on corporate action opportunities	8.15
• Developed market coverage	8.33
• Provision of market and regulatory updates	8.52
• Emerging market coverage	9.57

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METHODOLOGY

Beneficial owners are asked to rate the performance of their agent lenders across 12 service categories from one (unacceptable) to seven (excellent).

Unweighted methodology

All valid responses for each agent lender are averaged to populate unweighted tables. All responses are given an equal weight, all categories are given equal weight and no adjustment is made for differences in regional averages.

Weighted methodology

Step one – weighting for lendable portfolio: A weighting is generated to reflect to the size of the respondent's lendable portfolio. Each respondent is put into one of four groups depending on its lendable portfolio and assigned a weighting.

For the purposes of the 2017 survey all Asian responses are given a weighting of 1. Asian responses are not included in determining the quartiles.

Lendable portfolio	Weighting
Below first quartile	0.7
Between first and third quartile	1
Above third quartile	1.3

Step two – weighting for importance: A separate allowance is made for how important beneficial owners in aggregate consider each category to be. Respondents are asked to rank each category in order of importance. An average ranking is then calculated for each of the twelve categories. The weightings are within a theoretical band between 0 and 2 with an average of one to preserve comparability with unweighted scores.

Step three – regional variation: An allowance is also made for differences between average scores in each region to make meaningful global averages.

TABLES AND SCORES

The following scores are calculated for every qualifying agent lender: for each region (where the responding beneficial owners are based), a global total and a global average. Scores for service categories are calculated globally only.

All lenders tables

These contain all beneficial owner responses regardless of its relationship with the agent lender, whether custodial or third-party.

Lenders must receive a different minimum number of responses to qualify in each: seven in the Americas, five

responses in Europe, Middle East and Africa (EMEA) and four in Asia Pacific. To qualify globally, a lender must qualify in at least two regions.

Custodial and third-party agent lender tables

Ratings of lenders acting in a custodial or third-party agent lender capacity are recorded in separate tables. If the relationship involves both forms of arrangement, the response counts for both the custodial and agent lender tables. All the tables calculated for all lenders are replicated for custodial and third-party agent lenders separately.

The qualification criteria is lower for the custodial and agent lender tables compared with all lenders. To qualify for either the overall custodial and third-party agent lender tables, lenders need five responses in the Americas, four in EMEA and three in Asia Pacific.

Most improved

The agent lender that improved its score by the greatest margin over its equivalent 2016 score is the most improved firm. Agent lenders are ineligible if they did not qualify for the 2016 survey.

Service categories

Respondents are asked to rate each of their providers from one (lowest) to seven (highest) across 12 service categories. The ratings of respondents for each service category are averaged to produce the final score for each provider. The service categories are listed in the survey respondents box on page 9.

To qualify for each service category table, the lender needs the same amount of responses as to qualify for the corresponding main table; i.e., to qualify for an all lender, custodian or agent lender service category the lender must qualify in two of the three regions. A lender can qualify in some categories and not others – it does not have to qualify globally for every service category to be included in some categories.

VALID RESPONSES

For a response to count for the purposes of qualification, the beneficial owner must rate the agent lender in no fewer than eight of the 12 service categories.

It is possible for a lender to qualify globally or regionally without qualifying for all associated service category tables.

If a lender receives two or more responses in the same region from the same beneficial owner, an average of the ratings will be taken and it is considered to be one response (they are considered separate if for different regions).

Shaping up for success

Beneficial owners and industry experts met in Boston to discuss improving transparency, managing risk and the opportunities 2017 may bring for securities lending



PARTICIPANTS

Andrew Neil, associate editor, *Global Investor*
Bill Smith, managing director, Americas sales executive, JPMorgan
Nancy Allen, global product owner, DataLend
Pat Morrissey, head of trading, securities lending, The Vanguard Group
Josh Gray, associate director, securities lending and proxy governance, Russell Investments
Ori Porat, founder and chief executive officer, Fiducia Optime
Brendan Eccles, managing director, global co-head securities lending, Scotiabank
Jim McDonald, senior managing director, global head of trading, agency lending, State Street

What have been the most profitable trades, assets and markets for US asset owners over the last year?

Bill Smith: US beneficial owners have seen significant success around equity specials. Volatility has produced both deal-related and directional specials. That's been somewhat offset by reduced performance from high-quality fixed income portfolios – the impact of reduced broker-dealer balance sheet capacity has dampened demand for many of these securities.

Jim McDonald: Our clients had a very strong first half of the year lending equities. That trend began to fade toward the end of the second quarter as the market collectively began to reduce risk, resulting in a narrowing of spreads for many of the more popular single-name positions. The lack of balance sheet availability in the market has definitely squeezed fixed income to a certain degree. Even so, there were

opportunities for clients in collateral transformation trades and in cash reinvestment space as US money market reform produced attractive yields for clients that were investing in prime-like assets.

Nancy Allen: On a global basis, lender to broker revenue totalled \$9.15bn in 2016, roughly 6.3% higher year-on-year. The uptick in revenue globally can be attributed to some very hot securities, including a number of equity specials. Revenue from consumer discretionary stocks was approximately \$1.4bn. Tesla alone accounted for \$353m, roughly 3.8% of global revenue. The second highest earner was Celtrion, which earned \$148m.

Pat Morrissey: Vanguard only lends equities, more specifically, specials. We consistently see the top 10% of our securities on loan generate around 80-90% of total revenue. The voluntary corporate action specials space was

interesting for us – throughout 2016 we saw opportunities arise more frequently than in previous years.

Josh Gray: Similarly, Russell Investments only lends equities and is intrinsic-value focused. Earnings in our US securities lending programmes in 2016 came from directional demand in the consumer discretionary and retail sectors, as well as securities tied to energy/oil and the Chinese economy. Spreads weren't as wide in 2016, particularly in the second half of the year. We have also seen a contraction with our dividend-paying securities tied to the European markets, as borrowers are experiencing balance sheet constraints due to Basel III. In Germany, the German Federal Fiscal Ministry holding period around the record date has completely taken the trade off the table.

Brendan Eccles: In 2016 we paid a premium to counterparties that offered flexible collateral schedules. We're

US BENEFICIAL OWNERS ROUNDTABLE

looking to move away from cash and focus instead on term contracts. The extent to which beneficial owners are willing to be flexible and calculated with their risk-taking will determine how much premium they can extract.

To what extent is risk management determining the structure of lending programmes?

Ori Porat: I work with large asset owners on benchmarking and evaluating their entire custody relationship. Securities lending is part of that. My clients tend to evaluate securities lending on an overall proposition basis. It's often a risk decision. Initially, they don't think about returns. They just want their risk committee or governance oversight to be comfortable with the counterparty, the indemnifications, the contract and everything else.

McDonald: Risk management is a primary consideration for both State Street and our clients when determining how to structure an individual programme. It is critical for us to be able to offer a robust risk and reporting infrastructure as a minimum standard and then try to balance the conversation with clients around what type of programme to run as one that aligns expectations for returns with individual risk tolerance. Beneficial owners are genuinely engaged in evaluating programme performance and a high quality of risk management is a big part of the service that they expect.

Allen: As a performance measurement provider, we receive phone calls every day from beneficial owners. There is definitely a need for transparency and understanding of what is driving revenue. Beneficial owners are not only using tools to evaluate their agent – they are also evaluating their programme and finding ways to enhance performance.

Morrissey: Everyone should be aware that securities lending is not risk free. Ultimately, the aim is to provide risk-adjusted returns and offer seamless growth. We're entering an environment

where the quality and accuracy of reporting is crucial. Beneficial owners need to have a high-level understanding about those requirements. We look to agent lenders to be experts on all the legal, tax and regulatory matters in each market they trade in and each product they offer.

Gray: Reporting is definitely a key component of managing risk in the Russell Investments US securities lending programmes. Russell Investments is looking for complete transparency through the agent lender's reporting, which allows us to understand the securities lending trading strategies and risk at the fund level, not at the programme level. Russell Investments monitors exposures, looks at performance metrics and parameter requirements of our lending agents, and uses third-party benchmarking services to ensure loans are competitively priced in the market. Our programme's compliance is monitored daily. If proper guidance and programme insight doesn't exist, you can't effectively manage risk in a lending programme and anticipate potential issues.

Allen: We just undertook a complete overhaul of our performance reporting tool, called Client Performance Reporting. Our focus is on standardising that benchmark. In the past, tools available in the market have, on occasion, allowed agent lenders to control the peer group, and that peer group has not always been transparent to the beneficial owner. As a beneficial owner, if you have multiple agents using DataLend, you can be assured of the same peer group analysis across agents. Attribution analysis is important as well. A beneficial owner should consider – where are returns coming from? Am I making enough from intrinsic value lending? What does my cash reinvestment return look like? We are able to help answer these questions by providing attribution analysis information, thereby facilitating informed discussions between agents and beneficial owners.

McDonald: It's imperative that the interests of the client and agent are aligned. There are many clients that want to focus on intrinsic value only while others are interested in a more diverse programme and lending varied assets



“In the past, rates rising were challenging for securities lending earnings – very few people remember that”

**BILL SMITH,
JPMORGAN**

against different types of collateral. It's possible to manage multiple interests within the same programme.

Porat: Occasionally, when I speak on behalf of a client, a certain revenue sharing split and cash collateral management fee are put forward that are higher than I consider appropriate. I'll always argue that the client has options. When a vendor cites balance sheet capital, for example, I ask: 'Do you really want the client to go with a third-party lender?'

McDonald: Certainly the fees are an important variable for clients to consider, but it's important for clients to think about that in the context of the infrastructure, technology and operational facilities needed to manage a programme efficiently.

Porat: Not only does technology keep advancing but big banks are cutting costs, reducing headcount. While some costs keep going up, other keep going down. It's about keeping a fair balance.

Can market participants continue to innovate and adapt to regulation?

Allen: The impact of regulation on the cost of capital is leading to the market looking for more efficiencies and greater automation, which ultimately means a greater reliance on data. On NGT, EquiLend's automated trading platform, approximately 30% of the trade activity is non-GC, or warm to hot. Data is needed in order to capture these trades at the right value while using automation. This leads into the final step, which is performance monitoring and understanding of where returns are coming from.

Morrissey: Money market reform has impacted our business. We've had to adapt and make sure we understand what we're doing both from philosophical and process standpoints on a daily basis. We have to be strategic about the way that we think about trades. Borrowing demand is another important factor. Lately we have seen an increasing

"If proper guidance and programme insight doesn't exist, you can't effectively manage risk in a lending programme and anticipate potential issues"

**JOSH GRAY,
RUSSELL INVESTMENTS**

flow of demand coming in at less spread. It's not GC, but it's less spread than what we would like. Automation is going to be a key factor in helping us capture that incremental value for our shareholders. Innovative platforms such as NGT may help us get to that point.

Eccles: Collateral flexibility will continue to be a key factor. Another interesting trend we're seeing is a focus from some agent lenders on dealing with non-broker-dealer entities. We can deal out of other Scotiabank entities that are treated more favourably from a balance sheet perspective. We expect this to continue.

McDonald: Peer-to-peer lending will have a place in the market due to the constraints being felt by the typical intermediaries which is limiting capacity to service market activity to the levels they once did. We do see however peer-to-peer activity growing within the framework of the traditional banking system. Banks may not act as a credit intermediary, but their infrastructure and technology will be sought after.

Smith: We have experience with

beneficial owners that would engage in peer-to-peer lending but they do not have the operations capability. Their interest lies in using JPMorgan to provide a platform to process a peer-to-peer trade, rather than us being the traditional risk intermediary. That's an interesting extension of what we can offer.

Gray: Russell Investments is not currently active with peer-to-peer lending in our US securities lending programmes. The entities that we deal with are high-quality/transparent borrowers. Russell Investments will not lend to an entity that we do not have transparency into.

The US finally hiked interest rates at the end of 2016. What opportunities will rising rates bring?

McDonald: We are constructive on opportunities available to clients this coming year in the US cash market, depending on their reinvestment guidelines. A positively sloping yield curve should be a benefit in addition to the continued impact from the recent US money market reform that has reduced the level of investment in the prime money market space, which should



US BENEFICIAL OWNERS ROUNDTABLE

continue to make assets in that space cheaper for the clients that remain.

Smith: Participants have to be cautious. Rising interest rates aren't a panacea for low spreads. The two aren't entirely connected. Assuming that because rates are going up spreads will as well is too simplistic.

A potential benefit of interest rates rising is that it may create more volatility, which means there are more directional trades. Rising rates may produce opportunities, but that's as much about the cash collateral investment strategy of the investor as it is about the pace at which rates increase. In the past, rates rising were challenging for securities lending earnings – very few people remember that.

Allen: There is likely to be a greater search for yield, which then sets trading strategies. We've seen a 17% increase in our fixed income flow through NGT from the start of November, which is unusual. Toward the end of the year, fixed income flow normally declines. We believe the increased activity could be a result of short strategies in the market ahead of interest rate hikes.

Eccles: Low rates mean managers must have strong stock picking skills to profit from short-selling. It's easier to be a short seller when rates rise and hopefully the new environment adds balance to the securities lending market. It's been so long since we've had material rate changes. Most of our desk has never been through a blanket rate change. I guess that's good – because they have to keep some of us older people around!

Morrissey: As intrinsic value lenders, we don't see the correlation of interest rates rising impacting revenue.

Gray: Beneficial owners that are running a general collateral programme with a conservative reinvestment vehicle, will need to keep an eye on their spread. That's where beneficial owners are going to see the majority of those negative earning loans. If a monetary policy becomes more aggressive, such as a



“Beneficial owners are not only using tools to evaluate their agent – they are also evaluating their programme and finding ways to enhance performance”

**NANCY ALLEN,
DATALEND**

50 basis point move, beneficial owners may see some of these programmes struggling to meet those demands.

Will the change of administration have an impact on securities lending?

Allen: Securities lenders are keeping a close watch on the US political landscape. In the run up to the election, fees to borrow biotech stocks increased following negative rhetoric from one of the candidates. However, the election results meant those shorts were closed out, and fees dropped off significantly. On the other hand, solar power companies were under pressure immediately following the election. DataLend looked at 14 of the largest solar names in the immediate aftermath of the election. Average fees to borrow went from 160bps to 191bps over the course of a few days.

Eccles: Although still too early to tell, I'm surprised there hasn't been more volatility. Tax cuts and reforms could be perceived as being very positive. Similarly protectionist policies could be viewed as negative for the economy. It'll be interesting to see how it plays out..

Porat: This goes way beyond our industry. As per Newton's third law, for every action there will be a reaction. The divisive and uncompromising rhetoric in Congress for the last 20 years will mean there will be fierce opposition and lesser chance of bipartisanship on any issue whatsoever, so the question will be whether the administration can move past political gridlock.

Smith: It is too soon to say how the new US presidential administration may impact the securities lending business, but this business has historically demonstrated the ability to adapt to change as needed.

Gray: We will begin to see President Trump's actual fiscal policies after he has settled into office. There could be more market volatility. For example, he appears to be sceptical of alternative energy, so we could see some lending demand driven from that sector.

In what ways has demand from the primary borrowers been changing? How is this likely to play out during 2017?

McDonald: Most borrowers now have a

priority process they use for determining how they efficiently allocate their business on a trade-level basis. Many of these options may be friendlier to a borrower in terms of the impact on the balance sheet or in capital usage so it is increasingly important for a lender to be flexible in order to remain competitive.

Eccles: Anything that we can internalise helps us out enormously, so that's always our first priority. We are certainly active in the swaps market. Equity-for-equity with other brokers and banks is key. With our needs for funding we're certainly happy to lend securities out versus cash to other broker-dealers – that was almost taboo four or five years ago.

Smith: In a changing environment there is the risk of a disconnect between lender trends and borrower trends. If clients do not evolve and do some of the things that borrowers ask of them, then it may prove very costly to them. If you don't have the flexibility to match what the borrower is looking for, meeting their evolving demands, then you tend to miss out on valuable opportunities.

Eccles: Another trend we've seen is the larger, institutional-like hedge funds working more closely with us. That's beneficial for everyone. Previously, hedge funds would post the collateral they had on hand, now they are working with us to find appropriate matches. It's a teamwork approach. We've seen willingness to accept more equities as collateral, for example.

Allen: That mirrors what we've seen. Non-cash collateral grew in the US by 50% this year alone. Globally, non-cash is over \$1trn whereas cash is now at \$800bn.

Morrissey: We're not in a position where we're going to dramatically change our risk profile to try and capture additional revenue. It has to be risk-adjusted value.

While the OCC's centrally cleared volumes are steadily rising the widespread adoption of CCPs has yet to occur. Do you expect a notable shift in 2017?

Eccles: OCC's securities lending programme has made it much more attractive for broker-dealers to face each other. Previously, only one or two specific counterparties had a desire to use that structure. We saw that balloon in 2015 – we are now dealing with around 20 firms. It makes sense, especially if you have an options book to net some of your margin requirements off against. From a risk-weighted assets (RWA) perspective, its one-fiftieth of the charge compared to trading with a broker-dealer counterparty. EquiLend's recent purchase of AQS will mean the trend towards CCPs continues. We'd like to see agent lenders more involved, although that's a longer term goal.

Allen: We are seeing an uptick in demand for CCPs and are confident CCP use will grow. In 2016 we bought AQS and established EquiLend Clearing Services, which is partnering with the OCC to provide connectivity to its central clearing service. We did this in response to strong demand from our clients to offer seamless access to central clearing services. We continue to work with OCC on developing the right model for the market.

McDonald: CCPs are definitely part of our future, but there's still a lot of work to do. Models need to be more operationally robust in terms of how they manage processes for beneficial owners and agents. The capital benefits look significant though and, if the demand side migrates in that direction, eventually the supply side will follow.

Smith: Risk mapping is the real issue. The CCP model is a radical shift from bilateral transactions. An analogy may be the repo business, which years ago moved from bilateral to tri-party. However, the shift to CCPs is more complex. We have risk metrics that can help us assess the risk in CCPs – but the clients' perspectives on risk, and opportunities for risk mitigation, will be big questions.

Morrissey: We are taking a wait-and-see approach since CCPs need to be evaluated in terms of 40 Act Fund rules, indemnification and the processing of corporate actions. There are a lot of open-ended questions and we look forward to more discussions. It's still early in the game – maybe we'll hear more during 2017.

**"We're not...
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**PAT MORRISSEY,
THE VANGUARD
GROUP**



US BENEFICIAL OWNERS ROUNDTABLE

Allen: It will be interesting to see whether two-tier pricing develops once CCP adoption is widespread given the capital cost advantage of trading through a CCP. DataLend plans to capture data on CCP trades to provide transparency to beneficial owners.

McDonald: Both the borrowers and lenders will have their priorities for how they want to transact, which should produce an environment in which some trades will be centrally cleared and some will stay bilateral. Each will be priced differently. This selection process will

need to be matched through increased automation which will need to evolve in order to service a market that has become more diverse.

In 2016 the FSB identified asset managers lending directly as a source of systemic risk, SIFMA disagreed. What's your view?

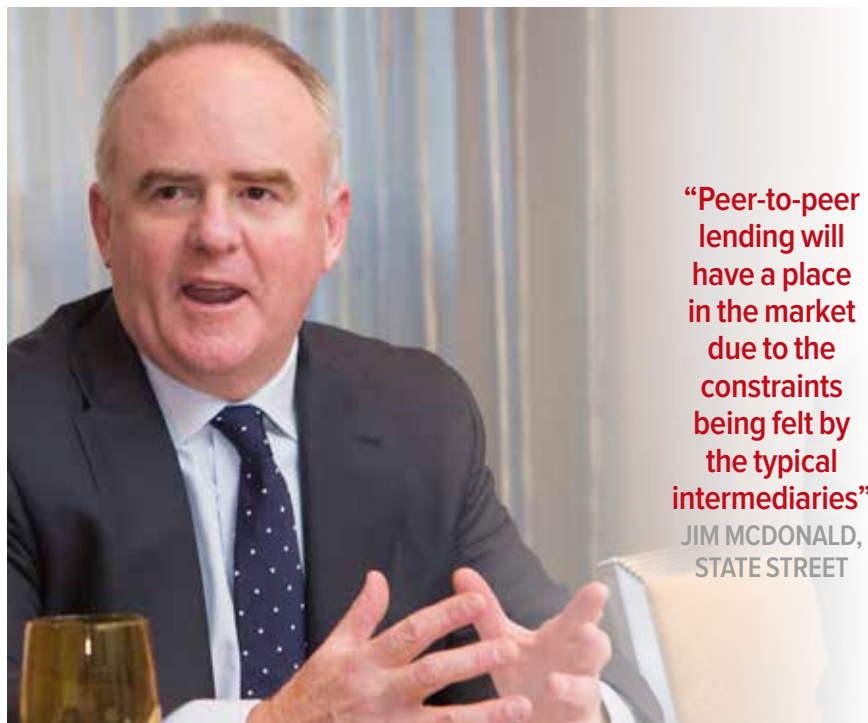
Smith: We're all going to be tasked with providing additional levels of transparency. Ultimately, it's good for the market because regardless of size, an institution's material mistake can have impacts across the broader market.

Porat: One important differentiator that seems to be lost on some regulators when it comes to systemically important institutions is the difference between market risk and ownership risk – the counterparty that has or doesn't have securities to produce. In the securities lending context, labelling managers as systemically important may make sense.

Eccles: Over-collateralisation should help, specifically for foreign equities. In a crisis, securities lending leverage comes down to the difference between the value of your collateral and your loans. During the Lehman crisis there were no major losses, certainly no catastrophic losses (away from the reinvestment side of the business). Securities lending wasn't a source of systemic risk. Still, it's always dangerous to use the past as an indication for the future.

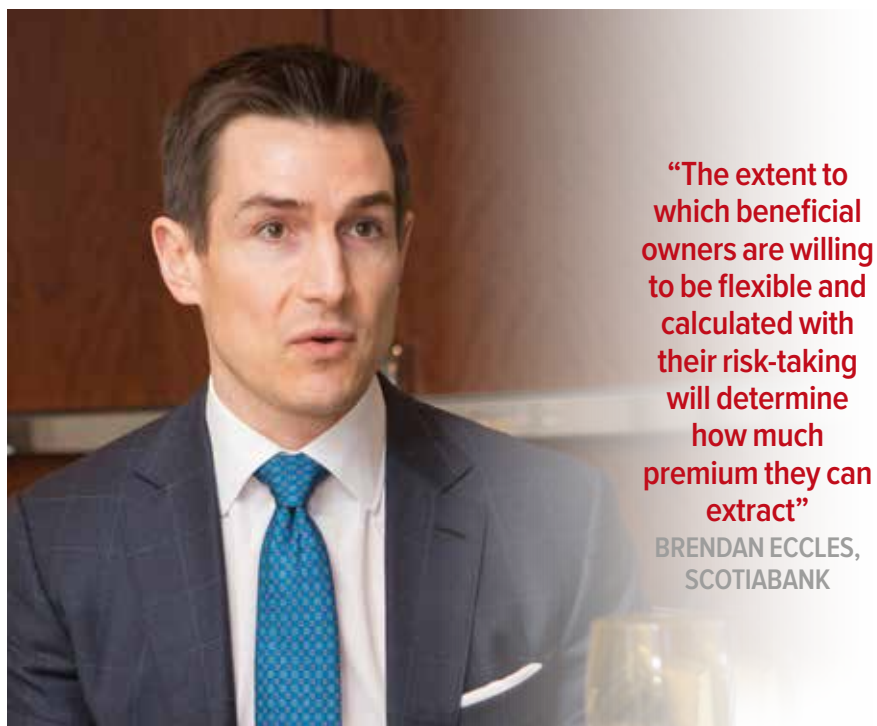
How will US participants be impacted by Europe's SFTR? Will the US eventually have its own reporting regulation?

Allen: EquiLend is working on a solution for SFTR. We're uniquely positioned to offer an outsourced solution given clients' existing links to our trading, post-trade and data services. We're working with industry bodies and market participants to determine the best way forward. Will the regulation then bleed into the US? I think so, in some form. Most participants, no matter where they're based, will be touched by SFTR and will



“Peer-to-peer lending will have a place in the market due to the constraints being felt by the typical intermediaries”

JIM McDONALD,
STATE STREET



“The extent to which beneficial owners are willing to be flexible and calculated with their risk-taking will determine how much premium they can extract”

BRENDAN ECCLES,
SCOTIABANK

need sufficient infrastructure. It will be fantastic from a data and transparency perspective.

McDonald: Agent lenders are expected to take care of SFTR for their beneficial owners. It's a significant undertaking, given the amount of transaction level turnover in some programmes. There are a lot of variables constantly moving. Eventually, we may see a global standard.

Smith: One of the reactions, intended or unintended, may be that small lenders become too expensive to maintain. There are many reasons to think that the barriers to entry for smaller lenders are rising. SFTR may bleed into beneficial owners' product development cycles – such as cloning funds for different jurisdictions. We're seeing some of that in the ETF space today.

Eccles: I find it hard to see something SFTR-like appearing in the US within four years. We've all heard speculation about the incoming administration's desire to roll back regulation. SFTR seems onerous and is out of line with what we're hearing.

What's the long-term strategic direction of the business and how can beneficial owners position for success?

Morrissey: Will we begin moving away from just value lending? No. Will we take equities as collateral? No. For Vanguard, 2017 will be a year of analysis and deeper understanding. Evaluating risk-adjusted strategies, both on our direct desk and with our lending agents, will form the bulk of the work.

Porat: Certain market participants are bullish on distributed ledger technology, or blockchain, and predict it will displace players in five years. That's too aggressive, but the financial services industry, including securities finance, needs to be wary of getting left behind. New technologies will certainly be a theme in 2017.

Smith: Blockchain may well play a role

“My clients tend to evaluate securities lending on an overall proposition basis. It's often a risk decision”

ORI PORAT
FIDUCIA OPTIME

in securities finance. How soon or where it begins to affect our specific business remains an open question but blockchain does seem to fit with prevalent themes including cost reduction, efficiency and building platform capacity.

I predict another round of business investment. There are incremental costs coming from a number of different places in order to meet transparency requirements and lender expectations. The business is going to become even more sophisticated.

McDonald: Returns should be good providing lenders figure out how to match off with demand. That requires more flexibility around structures and counterparties. The business is evolving and each participant will need to evolve with it or risk becoming less productive.

Eccles: Flexibility will be the key factor. The agent lenders and their beneficial owners that work with us and tailor efficient solutions to help minimise costs are going to be the ones that we'll do

more business with.

Allen: Greater tools and transparency will be available to allow beneficial owners to make educated decisions. Ultimately, that's good for agent lenders and borrowers from a capital perspective. In addition, automation will be vital, and more market efficiencies will result in optimal returns for all participants.

Gray: Russell Investments will continue to look for opportunities to add incremental income with risk adjusted returns in its US securities lending programme. As the market adjusts/ evolves due to regulatory reform and monetary policy, the firm will continue to have open discussions with its agents on how they are adapting to the change, if interests are still aligned and if flexibility and transparency is being offered/developed. Internally, Russell Investments will continue to monitor its programme governance and policies to ensure they are appropriate for current market conditions. 



South African Securities Finance Masterclass

Belmond Mount Nelson Hotel 18 May 2017

Agenda

1. Panel: Regulation

A panel will discuss the impact of regulatory change on securities lending in South Africa.

- Twin Peaks: What will be the impact of creating the Prudential Authority within SARB and transforming the FSB into the Financial Sector Conduct Authority?
- T+3: How has the JSE's shift to T+3 played out in terms of international interest, counterparty risk, fails, liquidity and borrower demand? What is the timeline for T+2?
- STT: 2016 changes went a long way to resolving the collateral constraints for lending participants. Do constraints remain significant?
- CISCA: CISCA opened up hedge funds to a new universe of investors and demand is expected to surge. Is there already signs of a boom? How else has it effected hedge funds?
- FTR: The implications of the EU Funds Transfer Regulation for the South African market
- SFTR/MIFID: The approaching wave of EU trade reporting requirements will have an impact far beyond the continent's borders. What consequences will there be for South African participants?

2. Presentation: Market infrastructure project landscape

The South African market is undergoing significant structural change. The speakers will consider the impact and timelines of things such as Strate's revamp of its bond clearing and settlement system (DIS) and the Treasury's new trading platform for South African sovereign bonds (ETP).

3. Panel: Collateral Optimisation

Optimising collateral has become important for banks facing tough regulatory rules and it is becoming increasingly important for asset managers and corporate treasuries.

- What constraints are there on managing collateral? What are the emerging solutions?
- Will the new ETP platform smooth the use of SA government bonds for use as collateral?

4. Panel: Total return swaps vs securities lending

Those seeking short exposure to the South African market have two primary options: TRS and SBL.

- What are the efficiency, cost and access implications of the TRS and SBL routes?
- Beyond South Africa, how can participants gain access to new markets in Africa?
- How do the nuances of each market determine the most efficient way of gaining exposure?

5. Panel: Creating a lending programme

Experienced practitioners discuss how to build an effective securities lending programme.

- How well have programmes performed and what can potential beneficial owners expect?
- How can returns from a lending programme be maximised?
- What international factors impact securities lending programmes?
- How can SA pension schemes boost revenue from their increasing international holdings?

6. Panel: Blockchain

Distributed ledger technology has the potential to increase the speed of settlement and security while reducing transaction costs.

- How could blockchain change the structure and dynamics of South Africa's markets?
- Progress on projects from Strate's Fractal Solutions, Digital Asset Holdings and others.
- How would blockchain work in a securities lending context?
- The importance of creating industry standards

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EquiLend has added **Ann-Marie Pearce** as associate director of sales in North America. New York-based Pearce joins from the surveillance and investigation department of Intercontinental Exchange. She also worked as a regulatory analyst for FINRA. In the securities finance space Pearce has managed client relationships and books of business at Jefferies Global Securities Finance, ING Financial Markets, Nomura Securities International Equity Finance. Leading trust and lending roles at Yasuda Bank and Trust Company and First Interstate Bank of California New York came earlier in her career.

Dag Rudiløkken is back at **Norway's DNB** after a six month spell at Nordea. Oslo-based Rudiløkken left DNB last August for a senior sales role within Nordea's equity finance business. He returned to the bank as a trader within the securities finance department. The latest move marks the third time Rudiløkken has joined DNB, Norway's largest financial services group. He was first hired by the firm in 2003 before moving to Carnegie Investment Bank three years later.

US investment bank **Cowen Group** has hired **Ross Levin** to build up its newly formed securities finance business. Levin, who joins after a six-month spell at tech firm Pleeco, has previously set-up a multi-asset prime brokerage at Itau. The New York-based tech expert has also held senior roles at ABN Amro and RBS during his career. His title at Cowen is director, global securities

finance. The firm established a securities finance capability in the summer of 2016 to complement its prime services business.

Mark Tidy has left his role of managing director and head of EMEA securities lending sales at **JPMorgan**, *Global Investor* learned. Tidy had been in the role since July 2011. He reported to Ann Doherty, co-head of EMEA investor services sales. When he took the role he initially reported to Stuart Thompson, then EMEA head of securities lending client management & sales. Tidy currently remains employed by the company but not in his former role.

Broadridge has added **Thomas Price** and **Peter Abric** to its securities finance and collateral management business. Price joins from FIS Sungard and is a former vice president of securities lending at both Goldman Sachs and Merrill Lynch. He is now vice president of relationship management at Broadridge and will focus on the firm's North American clients. Abric, who led Well's Fargo's equity finance desk for 15 years, will head up securities finance product sales for the technology firm. Both will work out of Broadridge's New York office.

Hedge fund body **AIMA** has bolstered its expanding footprint in APAC with the appointment of **Lilian Lee** as director and general manager for Singapore. Her appointment follows the recent hiring of Michael Bugel as the group's co-head of APAC. Lee joins from GIC Private, the sovereign wealth fund, where she was

most recently senior vice president, portfolio manager within the external managers department. Bugel joined AIMA's Hong Kong office last year from HSBC, where he managed senior relationships within the asset management sector for the firm's financial institutions group.

Boutique consultancy **The Field Effect** (TFE) has hired **Mark Barnard** to lead its securities finance practice. The industry veteran joins the firm from RBS where he headed up equity finance, liquidity management & derivatives. TFE specialises in clearing and collateral management strategy and works with CCPs, custodians, CSDs and investment managers. Recently it has been active in collateral and clearing technology, helping firms focused on derivatives, repo and securities lending.

Jeffrey O'Neill has left his role as global head of trading at **eSecLending**. O'Neill joined the firm in October 2013 and was based in the Boston office. He was responsible for all aspects of securities lending trading and strategy worldwide. O'Neill boasts 20 years of industry experience, with previous roles including global head of securities lending trading at Brown Brothers Harriman and global head of securities finance at K Capital Partners. He was also at State Street for 10 years, serving as vice president, head of global equity trading. eSecLending announced that **James Moroney** will be joining as head of global equities and corporate bond trading, effective February 27.

Nex Group, formerly Icap,

has made its first senior management change since its formation late last year, promoting a former Goldman banker who joined in November to replace the founder and chief executive of one its main tech units after he left the role. **Stuart Connolly**, who joined the group in November last year, has been appointed to replace Per Sjöberg, the founder and chief executive of Nex's TriOptima, after he said he is leaving that business. The firm said the appointment is subject to the approval of Sweden's Financial Supervisory Authority, which oversees the Nex's post-trade technology business.

Eurex Exchange's council has elected **Carola Gräfin von Schmettow** as chair. Gräfin von Schmettow, who is CEO of HSBC Trinkaus & Burkhardt, will serve a three-year term. A new vice chair and investor representative were also elected. Professor Dr Lutz Johanning of the WHU – Otto Beisheim School of Management was elected as vice chair, while Christophe Adam, global head of client operations at Societe Generale Newedge UK was selected as investor representative on the council.

CloudMargin has continued its rapid expansion with the appointment of **Filipe Rodriguez** as CTO. Rodriguez, who is based in London, will lead the global technology advances of the firm. He will report to Steve Husk, CEO of CloudMargin. Previously, Rodriguez led the technology team at currency swap platform WeSwap and introduced a wide range of improvements in processes and delivery lifecycle.

Eleventh-hour reprieve

Despite extensive preparations to handle daily margin calls the industry was far from ready on 1 March, says *Luke Jeffs*, leaving regulators little choice but to extend the deadline until September

The first of March brought the introduction of rules that require all firms holding swaps to start exchanging variation margin with their counterparties. But as the deadline approached several national regulators moved individually to offer reassurance that they

will be lenient in their treatment of non-compliant firms, so the impact on some firms may be deferred.

Yet the feeling on the eve of the deadline was that the industry has once again fallen well short of its mark and many firms were, at this very late stage, far from ready to process Variation margin on a daily basis.

Phil McCabe, head of collateral management at Bloomberg, said at the end of February: "I don't think anyone feels most people will be ready. Estimates vary between 10% and 30% of the market being ready but I suspect the real number is at the low end of that scale."

David White, the head of sales for triResolve, part of NEX's post-trade unit, said in mid-February: "It has been widely reported that variation margin presents a massive challenge. Some people have moved earlier but others are moving as quickly as they can."

McCabe said the hold-up is largely linked to the function of renegotiating contracts and upgrading processes to cope with daily margin. "Firms will normally have collateral agreements in place with counterparties but these need to be renegotiated under the new rules," he said. "If these agreements haven't been renegotiated then the firm is technically not compliant."

Operations challenge

The other challenge is operational. Firms need to be able to handle the exchange of Variation margin on an intra-day basis which is no small undertaking.

Few firms found themselves facing the Variation margin implementation challenge from a position of strength, said McCabe. "The industry splits into three groups. The firms that are already exchange variation margin on a daily basis, often via a manual process. Those firms that process variation margin

on a weekly or monthly basis. And those that don't handle variation margin at all."

Lee McCormack, head of strategy and product development at tech firm CloudMargin and a former director of swaps clearing at Nomura and Morgan Stanley, said ahead of the

deadline: "Is there a chance people could get locked out of the market? Definitely. I suspect the current issues will be around for at least a month."

But the lack of compliance is not an immediate problem for firms as most of the main national regulators have offered assurances over the past months that they will not punish non-compliance for a few months at least.


McCabe said: "Various regulatory authorities are showing leniency of some sort by pushing out the implementation deadline or stating an intent to recognise when firms are making every effort to comply with the prescribed deadlines."

Pragmatic approach

The US was emphatic in its intervention when it issued on 14 February a no-action relief letter that effectively gave firms an extension of six months to 1 September to ensure their compliance. Regulators in Hong Kong, Singapore and Australia said last year they will take a pragmatic approach to the introduction of the rules.

The European Supervisory Authorities, including the European Securities and Markets Authority and the European Banking Authority, took a more nuanced line on February 23 when they said they would defer the application of the Variation margin rules to national regulators.

McCabe said: "Europe and Canada have said they expect large firms to have complied by March but they will show leniency where a smaller firm can demonstrate it has made efforts to be compliant. For Europe, I think we can assume the grace period will extend to 1 September when the next initial margin rules take effect."

Firms have a few months to get themselves in shape to comply with the Variation margin rules but they can be sure their regulators will change their tone in September. 

"Estimates vary between 10% and 30% of the market being ready but I suspect the real number is at the low end of that scale"

PHIL MCCABE, BLOOMBERG

Most of the main national regulators have offered assurances over the past months that they will not punish non-compliance for a few months

The rise and fall of Nasdaq NLX

The US exchange group tried hard for four years but ultimately failed to break the duopoly of ICE Futures Europe and Eurex, writes *Julie Aelbrecht*

The future of Nasdaq NLX has been in doubt for months but in late January Adena Friedman, the new chief executive of the US exchange group, finally drew a line under the group's bid to break into the European interest rate futures market.

Nasdaq said NLX will stop trading on April 28 2017, almost four years after the ambitious new platform went live mid-2013 to provide competition to the incumbents in the European market.

Back then the market was abuzz with optimism. NLX chief Charlotte Crosswell was backed by a strong team with black books that covered every corner of the City. Bringing the two ends of the yield curve together would result in huge margin efficiencies for banks while the lower fees would draw in prop traders.

Its first year was a stellar success, trading volume surpassed the reported 10% market share target on numerous days and, with the cross margining of over-the-counter and exchange traded derivatives just around the corner, the future looked bright for this fledgling market.

As its first anniversary approached, NLX claimed a 30-day moving average market share in Euribor of 12% and experienced a record day with almost 200,000 contracts traded. Over 2.5 million contracts were traded during May 2014.

Delayed decision

But the honeymoon period came to an abrupt end just days after its first anniversary. On 4 June, a fat finger error by one of its prop members mispriced a number of orders resulting in a price spike.

Such events are not unknown but NLX took hours to respond to the error and make a decision on what to do. After heated internal debate, it decided to bust the erroneous trades but did not cancel the trades made further down the curve, leaving some trading firms seriously out of pocket while the perpetrators of the error were made good.

The delay in the decision and the decision itself were a

serious blow to the integrity of the market and at least one of its major liquidity providers pulled out.

Distorting incentives

Just days later, another scandal hit the exchange. It was common knowledge across the industry that NLX was paying huge incentives to trading firms to trade and that this was resulting in a spike in trading volumes at certain times of the day.

Crosswell moved to iron-out the volume over the trading day by adjusting the incentives to include more sessions but this resulted in yet more spikes of trading volumes. It was clear some market participants were simply trading to get the rebates. At the same time, the FCA was understood to be looking into the incentive schemes. It had of course approved

the schemes, but the negative publicity forced it to review.

At the end of 2014, Crosswell moved to end the incentives and the impact was immediate. By the end of December monthly volumes had fallen to 330,000, having averaged between 1.5 and 2m for the previous 10 months. By its second anniversary in May 2015, volumes had

fallen to 75,000 reaching a nadir of 20,000 in August. In April 2016 Crosswell announced her decision to step down and most of the NLX team was let go shortly afterwards.

“The honeymoon period came to an abrupt end just days after its first anniversary”

Curveball

By then the LSE had announced plans to launch its CurveGlobal market, a look-a-like of the NLX platform. It had signed up a number of banks as shareholders and was due to launch in the coming months.

By the time the cross-margining service had been launched at SwapClear, Curve was ready to launch with the backing of a number of the banks that NLX had pitched to transfer their books to its market. The fate of NLX was effectively sealed.

While some may welcome the end of NLX, it is a sad end to a good idea and another nail in the coffin of competition in European derivatives markets. ☹

Props wary of EBA's reforms

European proprietary trading firms are fearful of the potential impact on liquidity of the EBA's new prudential regime, says *Julie Aelbrecht*



EBA executive director Adam Farkas

Proprietary trading firms are becoming increasingly worried about new prudential regulations proposed by the European Banking Authority (EBA). In November, the EBA proposed a new prudential regime for investment firms to supplement the existing Capital Requirements Directive and Capital Requirements Regulation (CRR).

The EBA wants to reform the capital rules for firms that are not banks or systemically important, the main focus of its capital reforms to date. All firms had until 2 February to submit their feedback to the banking regulator.

While there is disagreement about the nature of the proposals, the consensus among European props is that, while the spirit of the EBA's November discussion paper is in itself sensible, the details need work.

"For our proprietary trading clients, any regime that is better tailored to non-systemic investment firms, is simpler and has less discretion for national supervisors would be preferred,"

said Conor Foley of Norton Rose Fullbright, a law firm that represents many prop traders.

The new proposal would see a new categorisation of firms distinguishing between systemic and bank-like investment firms (category 1), investment firms that are not systemic (category 2), and very small firms (category 3). An individual firm's categorisation is based on the risks it poses to customers, the market at large and the firm itself.

"It is a step forward to see that the EBA agrees that firms that present the least systemic risk and the smallest firms with least impact on consumers, should be treated differently or separately," said Stephen Taylor, chief risk officer at the Tower Trading Group. "It is however worrying that there are no details around the precise metrics and measurements that will determine into which categories firms will eventually fall."

Capital requirements

The calculation of capital requirements is based on a risk approach, which uses so-called k-factors including assets

under management, client money held, liabilities to clients and proprietary trading activity. Most of the metrics set out in the EBA's proposal, in other words, are targeted at bigger, systemic players, assessing risk to the market and risk to consumers.

"Until we know the metrics, there is no way of accurately saying whether the k-factors or the uplift factors will apply to us and if so, the impact these factors will have on the dollar-value of our capital requirements," Taylor added.

Other market players disagree on the nature of the proposal and have singled out two problematic elements; the proprietary trading activity k-factor and the up-lift factor, which could see individual firms' leverage ratio introduced as an indicator of risk.

Traders fear these factors could come with unintended consequences and could act as a disincentive for these firms to act as liquidity providers.

Experts feel the rules could have a negative effect on the market's smaller players: "I do not believe the EBA's proposed approach is proportionate as it stands. Investment firms will welcome

a new regime based on fixed overhead requirements but the EBA needs to be more realistic about the classification of investment firms. The proposed classification is too restrictive now," Foley added.

Additionally, Foley argues the rules set out in the proposal disregard rules already in place that regulate the activity of smaller firms, including the MiFID regimes, clearing rules, investor compensation schemes and national rules.

"Our clients do not accept that they pose risk-to-market as assessed by the EBA. We have seen proprietary trading firms fail periodically but we have not seen corresponding market volatility, reduction in liquidity or other market participants reducing positions," he said.

There is a question mark over timing. The EBA's discussion paper is the precursor for a consultation paper on the same subject, which will be followed by two years or more of drafting legislation, technical standards and approvals of the new rules by the European Commission and various regulatory bodies. 

"The EBA needs to be more realistic about the classification of investment firms"
CONOR FOLEY,
NORTON ROSE FULLBRIGHT

LSE Derivatives Market set for further growth

London Stock Exchange Group's focus on innovation and building liquidity results in increased activity in Italian and Russian derivatives

LSEG's Italian Derivatives Market (IDEM) has grown in recent years to become one of Europe's best established futures and options markets.

Boasting a healthy mix of institutional investors, retail traders and market-makers, the exchange traded a daily average of over 200,000 lots last year worth over €5bn (£4.3bn).

Nicolas Bertrand, Global Head of Derivatives and Commodities at London Stock Exchange Group, said: "The Italian market is once again the star of equity derivatives in Europe. 2016 was not a particularly good year for European equity derivatives but IDEM performed well."

Bertrand added: "The FTSE MIB future, for example, was up 10% and turning over €3.5bn per day last year. In total, IDEM turns over an average €5.1bn a day and reached a record 4.6 million open position at CC&G, the Italian clearing house and part of Borsa Italiana."

The LSE said IDEM is seeing growing interest from international buy-side, such as commodity trading advisors (CTAs) and hedge funds while its index futures and options segment is now at a level where it is drawing attention from the largest asset managers and pension funds.

Bertrand said: "An interesting added benefit is diversification: The FTSE MIB has a rather low correlation to other European indices, it is a product in its

own right. It has also proved a good proxy for the European banking sector at large and brings together a perfect combination of banks, wholesale firms and 27 market-makers. IDEM's index options business was up 23% in 2016."

The LSE is looking at new additions however, and is actively promoting its weekly options, dividend futures and its European style options.

Bertrand said: "Weekly options on FTSE MIB Index and on most liquid equities were introduced, and have now traded more than 1.5 million lots since launch; also, last year the market launched European-style stock options to address growing demand from long-only funds and Banking Foundations. All initiatives were backed by strong support from the global electronic market-making community since day one."

The LSE Derivatives Market (LSEDM) International Order Book (IOB) also trades derivatives products based on Russian equities. This market has been slower but Bertrand said he has seen in the past six months an increasing diversity of clients tapping that segment.

"This is partly because of the strong performance of the domestic Russian market, along with the currency. The IOB stock option market on LSEDM now has open interest of about 800,000 lots for example and January 2017 is up around 1,000% against January 2016."

Bertrand said Russian energy giants

Gazprom and Rosneft are the leading options.

"In Russia, we've seen a pick-up in the estimated forecasts of dividend earnings; we offer a unique dividend future segment that is generating interest among clients. It is also a cleared product so less capital intensive than its over-the-counter equivalent."


Bertrand added: "We have recently introduced EFP (Exchange-For-Physical) capability, which is another example of us responding to client demand."

LSEDM introduced in late February 2017 EFP reporting for all products, which should help build liquidity across the board including the Turkish BIST30 index products.

Bertrand said the LSEDM strategy is focused on two core principles: liquidity and efficiency.

He said: "Derivatives liquidity is always at the top of the agenda for the buy side, particularly in the aftermath of regulatory changes such as the Volcker rule. We have worked extensively with clients to address this issue, operating at the edge of our products to fine tune our offering and improve our market microstructure."

Bertrand continued: "At LSEDM and IDEM, we have always focused on innovating and delivering operational efficiency based on end-to-end processing with our clearing houses, LCH and CC&G."

He concluded: "We introduced pre-trade risk controls in November 2016 and it is our plan to deliver that on IDEM in the first half of this year. This is no longer a nice to have, rather firms need better control of their orders from a risk management perspective." 



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US President Trump's executive order compelling a review of all financial laws and regulation has been interpreted by some as the new administration's first step towards dismantling post-crisis reform Dodd-Frank. Legal experts, however, have pointed out the president's powers are limited in this respect and progress is likely to be slow.

The order consisted of two main parts. The first outlines the policy to regulate the US financial system along seven core principles, including empowering American citizens to make independent financial decisions and enabling American companies to be globally competitive.

The second part of the order compels the Secretary of the Treasury to consult with the member agencies of the Financial Stability Oversight Council (FSOC), which include the Securities and Exchange Commission, Commodity Futures Trading Commission and the Federal Reserve, to review existing laws according to these core principles within 120 days.

The initiative was widely applauded by the industry. Legal experts, however, have said that the jubilant mood may be premature.

"My feeling is that it is more a sense of the direction this administration wants to go in rather than a direct order to repeal a specific law. The executive order does not mention the repeal of Dodd-Frank. [Although] That is not to say it won't have that effect," said Margaret Sheehan, partner in the finance practice of law firm Ashurst in the US.

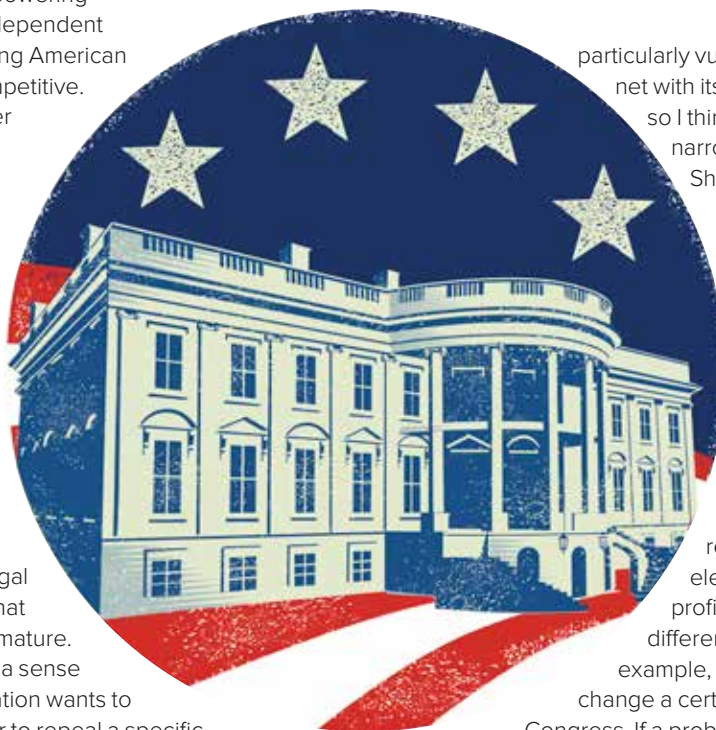
Repealing Dodd-Frank would be a complicated affair. The reform, enacted in July 2010, spans over 850 pages and governs subjects as diverse as capital requirements for banks, whistle-blower protections, agency funding, mandatory clearing for swaps and the registration of hedge funds.

"Dodd Frank consists of so many different rules that wholesale repeal isn't a relevant concept. There is no desire to go back to a pre-Dodd-Frank era. It has been eight years since the law was implemented and a lot of it is already baked into the system," said Guy Dempsey, of counsel at law firm Katten Muchin Rosenman in the US.

If wholesale repeal is not an option, the agencies and Congress could choose to amend aspects of the Dodd-Frank Act, such as the Volcker Rule. "I think the Volcker rule is

Wishful thinking

President Trump issued a much-anticipated executive order to review all financial regulation in February but reform of Dodd-Frank will be slow at best, says *Julie Aelbrecht*



particularly vulnerable. It casts a very big net with its definitions of private funds, so I think there will be a move to narrow the Volcker Rule," said Sheehan.


This is where things get complicated from a legal perspective. The Volcker rule is a law. The law prohibits banks from engaging in proprietary trading but there are hundreds of pages of implementing rules across multiple agencies.

"In the review, the regulators may identify elements with different legal profiles, which would require a different approach. The CFTC, for example, could have the power to change a certain implementing rule without

Congress. If a problem is in the statute, the law would have to be repealed to get rid of the requirement," Dempsey said.

In other words, while agencies such as the CFTC and the SEC can eliminate the implementing regulations, the law itself can only be amended or repealed by Congress. The executive branch, i.e. the President, cannot repeal laws. It would take an act of Congress to eliminate Dodd-Frank, or even some of its parts. Most likely, a bill would have to be passed that amends the existing rules.

There is also the possibility of a repeal-and-replace tactic, where the House of Representatives could repeal Volcker and replace it with a new one immediately afterwards. Dempsey, however, pointed out that a repeal-and-replace has never been executed before.

The bottom line is that enacting reform could take years. "Inertia is a powerful force. It takes a crisis to get anything done. There is no event driving this regulatory overhaul, except a change in administration," Sheehan concluded. 

Lessons from US thinking

European firms should prepare for several different outcomes of MiFID's swaps trading rules, writes Tradeweb's *Enrico Bruni*



Right around the summer of 2013, just as the final rules for swap execution facilities (SEFs) were being entered into the Federal Register, many industry-watchers were forecasting the impending death of the US swaps market.

In fact, the transition to mandatory electronic trading of swaps in the US had no such effect. Quite the opposite. Immediately following the mandate, an August 2013 report from Aite Group showed that US derivatives market participants absorbed Dodd-Frank trading requirements in their stride, with cleared interest rate (IRS) and credit default swap (CDS) trading volume surging in the weeks following new clearing mandates and the final SEF rules.

Now, over three years after the mandate was published, Clarus Financial Technology reports the total volume of USD IRS trading taking place on SEF platforms is continuing to thrive, with over \$1.3trn in notional trading in December 2016 alone.

Fears reappear

With less than a year until MiFID II comes into force, bringing with it several similar regulatory hurdles for swaps market participants to overcome, many of the same fears are starting to emerge in Europe.

Naturally, the US experience has emerged as a benchmark for what to expect and how to prepare. While there are many similarities between the two reforms, there are also many details unique to each that could complicate things for firms that don't take a rigorous, but flexible approach to MiFID II preparation.

Let's start with the similarities. The big fear with both mandates is that these severe changes to the trading workflow – movement of trades onto electronic platforms, mandatory clearing, automated trade reporting – could adversely affect market structure.

What US market participants quickly found in the Dodd-Frank experience was that flexibility and efficiency were the keys to liquidity and profitability. By moving IRS and CDS swaps trading onto electronic trading platforms, market participants are able to realise enormous gains in efficiency that offset the challenges presented by new trading requirements. It is

therefore critical that MiFID II preparations centre on trading efficiency as a primary goal.

To achieve that ultra-efficient, integrated workflow, firms need to be able to connect internal risk, compliance, accounting, collateral and order management systems (OMS) with external trade execution and processing functions, such as clearing houses.

Market fragmentation

When it comes to navigating the differences between the two regulations, one of the biggest issues market participants will need to contend with is the inherent fragmentation that will exist between the two sets of laws. While regulators on both sides of the Atlantic have repeatedly stressed their intention to harmonise their rules to avoid this fragmentation, the real potential exists for MiFID II to create distinct silos in the swaps market, with US firms trading primarily with other US firms and European firms trading primarily with other European firms, and so on around the globe.

Fragmentation could lead to inefficiency and increased costs for market participants and end-investors alike. To maintain functioning global markets, regulators need to establish clear and workable cross-border rules using regulatory tools, such as substituted compliance, exemptive relief and equivalence. Following the financial crisis in 2008, regulatory reform has been driven by the same objectives of reducing systemic risk, increasing transparency, and improving market efficiency. Reaching an agreement should, therefore, be achievable and a desired outcome for all parties concerned.

However, with many of the details of cross-border equivalence still unknown, market participants need to be ready for a number of different potential outcomes. Just as we saw with Dodd-Frank, as fears mounted that US traders would simply pack up and move their operations to less restrictive regimes, the power of efficient, transparent trading on electronic platforms kept them engaged.

Ultimately, we expect the same outcome with MiFID II. ☺

Enrico Bruni, managing director, head of Europe and Asia business, Tradeweb

Trading trends

2016 saw large spikes in volatility due to geopolitical events, extensive growth in the power markets, as well as Asia's trading boom coming to an abrupt end. *Julie Aelbrecht* analyses Euromoney TradeData's numbers for the year

Trading volumes of futures and options went up 3% across global exchanges during 2016, with the increase almost entirely focused in North America and Europe while trading in Asia-Pacific was flat, according to recently compiled statistics from Euromoney TradeData.

In 2016, volumes grew 6% on North American exchanges to a total of 7.4 billion contracts, while trading on European exchanges increased by 4% to 3.2 billion lots, up from 3.1 billion in 2015. Trading on South American exchanges, a less prominent region for derivatives, was up 12% to 1.6 billion lots.

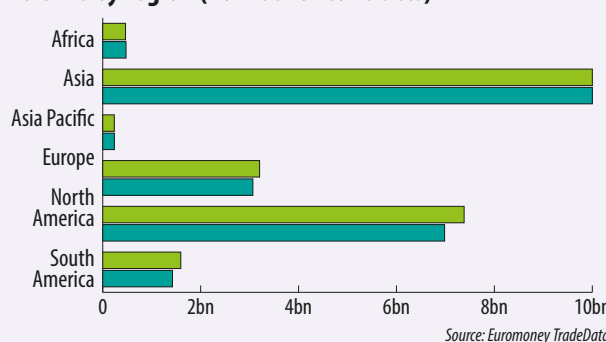
By contrast, Asia marginally decreased with 10.9 billion lots traded during the year. The low growth in Asia stands in stark contrast to the region's numbers in 2015, when it overtook North America as the world's top futures and options region by volume. Between 2014 and 2015, trading in Asia rose a fifth to reach a regional total of 10.9 billion, while trading in the US and Canada fell 6% to 7 billion.

Peak volumes

2016 saw two of the four busiest months since the financial crisis. Due to political uncertainty and increased Asian commodity trading, March and November last year were the second and fourth busiest months since 2008.

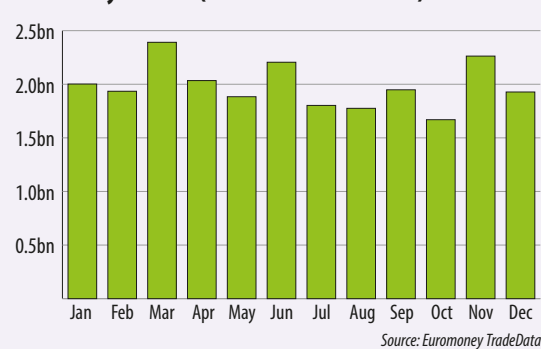
March 2016 was second only to August 2011, when fear

2016 vs 2015 future and options trading volume by region (number of contracts)



over the contagion of the European sovereign debt crisis swept markets across the globe. The record number of trades in March was mainly driven by high volumes in Asia, where trading volumes were up a third compared to the same month in 2015 to 1.1 billion lots. The increase was focused on the commodities markets, with a 268% increase in energy trading, a 215% hike in metals trading and a 97% rise in agricultural derivatives trading compared to the same month in 2015

2016 future and options trading volume by month (number of contracts)



Trading was up significantly in all regions in November, after the surprise election of Donald Trump as President of the US and a constitutional referendum in Italy. The biggest increases in trading were in South America, where trading was up 72% to 155 million lots. In Asia, volumes went up 52% to 1 billion lots, and North America, where trading increased 48% to 761 million lots. Europe saw a 27% rise in trading for the month.

Asset classes

On average, there was more growth in trading commodities derivatives than financial derivatives. Trading in energy, agricultural products, metals and softs grew 39% across the globe to 6.4 billion lots, up from 4.6 billion in the previous year.

Growth in commodities was mainly focused in Asia, where trading increased 54% to 4.4 billion lots, and North America, where it rose 19% to 1.4 billion contracts.

Looking at the individual asset classes, the strongest increase was in energy trading. Energy trading was up 60% on exchanges across the globe to 2.3 billion contracts traded.

Although there were double-digit increases in every region, the starkest difference between 2016 and the previous year was in Asia, where trading increased a whopping 169% to 1 billion lots up from 386 million the previous year. The North American energy

2016 vs 2015 future and options trading volume by asset class (number of contracts)



markets grew a quarter to trade 870 million lots over the course of last year, while European energy trading went up 13% to 427 million contracts.

Trading in metals also grew strongly in 2016, with a 37% increase in trading across the globe to a total of 2.2 billion lots. In this sector, the Asian markets also performed the best, with a 43% rise in trading to 1.9 billion contracts. Trading on the much smaller North American metals hubs went up by a third to 116 million contracts, while European trading was down 9% to 154.5 million lots compared to the previous year.

Agricultural products were up a quarter across the globe, with a total of 1.6 billion contracts traded in 2016. The biggest increase was once again in the Asian markets, where agricultural trading rose a third for the year, totalling 1.3 billion contracts. Trading on the European exchanges was down 4% to 13.8 million lots, while North American trading was up 4% to 341 million contracts.

Trading in the much smaller softs sector was stable at around 294 million contracts traded on exchanges across the globe. In this sector, the European market grew strongest, with a one quarter increase to 19 million contracts. The Asian markets grew 3% to 200 million contracts for the year. The North American exchanges ended the year at 74.5 million lots, an increase of 9% compared to the figures for 2015.

Trading in financial products was much less consistently positive, with big

regional variations. Trading in interest rate derivatives grew 8% globally, with stark differences between regions. Interest rate derivatives trading grew 12% on North American exchanges and 6% on European exchanges to 945 million lots. Trading in the instruments dropped 7% in Asia to 85 million lots, while it grew a tenth to 129 million contracts in the wider Asia-Pacific region. South American trading, meanwhile, decreased 3% to 423 million lots over the course of 2016.

Equity options and futures trading on the global derivatives markets fell a tenth on the previous year to 1.2 billion contracts. While trading increased in the North American markets by a third to 11.8

million contracts, the larger trading hubs in Asia and Africa reported losses.

The Asian exchanges reported a 14% drop in equity trading to 635

million lots, while African trading, mostly concentrated on the Johannesburg Stock Exchange, fell 7% to 358 million lots. European equity derivatives trading was flat at 161 million contracts for the year.

Equity index trading was off a fifth compared with the previous year, to 5.5 billion contracts traded on exchanges across the world.

The biggest loser in this category were the Asian exchanges, where trading in index derivatives fell a third to 3.4 billion contracts from 5 billion in 2015. European equity index trading grew a modest 4% to 1.3 billion contracts over the course of

“Trading was up significantly in all regions in November, after the surprise election of Donald Trump as President of the US”

2016, while trading on North American exchanges rose by 8% to 1.4 billion lots.

Exchanges

The fastest growing exchange of the year was the Deutsche Boerse-owned European Energy Exchange with a 267% growth rate. The top five had two other energy markets: the American Nodal Exchange, whose traded volume grew 233% over the course of last year; and Powernext AS, where volumes grew 68%.

According to Steffen Koehler, chief operating officer of EEX, the high volume in 2016 was due to several factors: “In 2016 we saw extremely high volume due to volatility in the market, but also a big structural change among our members. When we look at the member rankings for last year versus those in 2013, we can see that the banks are back in their historic role. Not in the proprietary business, but in the customer business.”

EEX’s offering on the power derivatives market covers eleven market areas. The exchange launched financially-settled cap futures for the German intraday market late in 2015 and expanded its offering on the power derivatives markets by introducing more short-term maturities on the contracts in June. The exchange also added a wind power future in October. “Our new offerings also grew successfully. In the regional markets, we had a triple digit growth rate for Spain and Switzerland and we broadened the offering. There was also structural change with the growth in options contracts for renewables,” Koehler says.

The exchange plans to continue its strategy from the previous year. “This year we will base ourselves on the 2016 strategy, we will put the focus on growing our market share in our home market and expand from a regional and structural perspective,” he adds. ☺

“The low growth in Asia stands in stark contrast to the region’s numbers in 2015, when it overtook North America”

“Banks are back in their historic role. Not in the proprietary business, but in the customer business”

STEFFEN KOEHLER, EEX

FOW: APPOINTMENTS

The president of the Intercontinental Exchange's European clearing house **Paul Swann** is set to retire from his post to be replaced by the head of the US exchange group's benchmarks unit. Swann, who founded **ICE Clear Europe** in late 2008 with its former chief operating officer Mike Gibson, is to leave the London-based clearing house in the middle of this year, less than a year after Gibson also left the firm. Sources close to the exchange said Swann is set to be replaced by Finbarr Hutcheson, currently the president of ICE Benchmark Administration, which runs price benchmarks including the controversial London Inter-Bank Offered Rate (LIBOR).

Nasdaq Futures has appointed the head of US energy trading firm Tethys Capital to chair its advisory board, replacing Steve Roberts, the chairman of London-based Oak Futures who has stepped down after his term expired. **Robert Finnegan**, the president and chief executive of Chicago-based Tethys, has been approved as the chairman of the NFX advisory group and is set to oversee his first board meeting in the middle of March. Roberts stepped down earlier this year after his one year term as chair of the advisory board expired, according to a source.

CME Group is to part ways with two US-based senior directors, marking the latest management changes at the US exchange giant under new chief executive Terry Duffy. The Chicago-based exchange giant is set to part ways with **Robert Zagotta**

and **Umesh Gajria**, two senior figures in the Merc's US-based team, though the timing of their departures is unclear. Zagotta has been with the Merc in Chicago for more than four years and has served as a senior managing director of strategy and execution since September 2014.

BGC Partners has parted ways with its New York-based head of futures and options in the latest personnel change at the inter-dealer broker as it moves to grow its listed derivatives business. US-based BGC ended its association with **Simon Andriesz**, its managing director and head of futures and options for London and the Americas, at the end of January, according to a filing on the US National Futures Association website. Andriesz is vastly experienced, having initially joined BGC in London over four years ago from Nomura, where he was the Japanese bank's European head of futures and options for nearly three years.

David Mudie, the former chief executive of RJ O'Brien's European arm, has resurfaced as chief executive of London-based futures and options firm **Sigma Broking**. Mudie, who left RJO UK in June 2016 after three-and-a-half years as chief executive, told *Global Investor* he joined Sigma Broking as its London-based chief executive in early February. Sigma Broking, which offers clients access to most of the world's top futures and options exchanges including Eurex, CME and CBOT, currently hires about 70 staff across two offices in London and New York.

The US Commodity Futures Trading Commission's general counsel **Jonathan Marcus** has said he will leave the agency, in the latest senior departure from the US regulator. Marcus joined the agency in 2011 as deputy general counsel and moved to his role as general counsel in 2013. Acting chairman of the **CFTC** Christopher Giancarlo confirmed that Robert Schwartz, the current deputy general counsel for litigation and adjudication, will serve as acting general counsel in the interim.

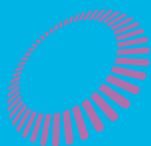
Prop services group **Marex Pro Trader** is set to hire **Harvey Moses**, a vastly experienced salesman latterly with rival RJ O'Brien. London-based Pro Trader, part of commodities group Marex Spectron, is set to hire Moses in the coming months but no date has yet been set for his appointment, according to the firm. Moses will become head of business development at Pro Trader, reporting to Stephen Hills, the head of the Pro Trader business. Hills said: "Having made significant investments in technology and infrastructure, we are today better able to meet the diverse needs of even the most demanding clients."

More than 20 former **Tower Trading** traders including the prop firm's former heads of operations and risk manager have joined a new Essex-based prop trading firm called **Vega Capital London**. Tower Trading's former operations head **Adrian Spires** and its former risk manager **Tommy Gaunt** and about 20 traders have joined Vega Capital London in recent months. "We're very excited about the

future of Vega Capital and are looking at all asset classes. We looking to grow our presence, possibly in London, but also globally," Spires told *Global Investor*. Spires, who served as Tower Trading's head of operations for seven years, left that firm on May 23 2016, according to the FSA Register.

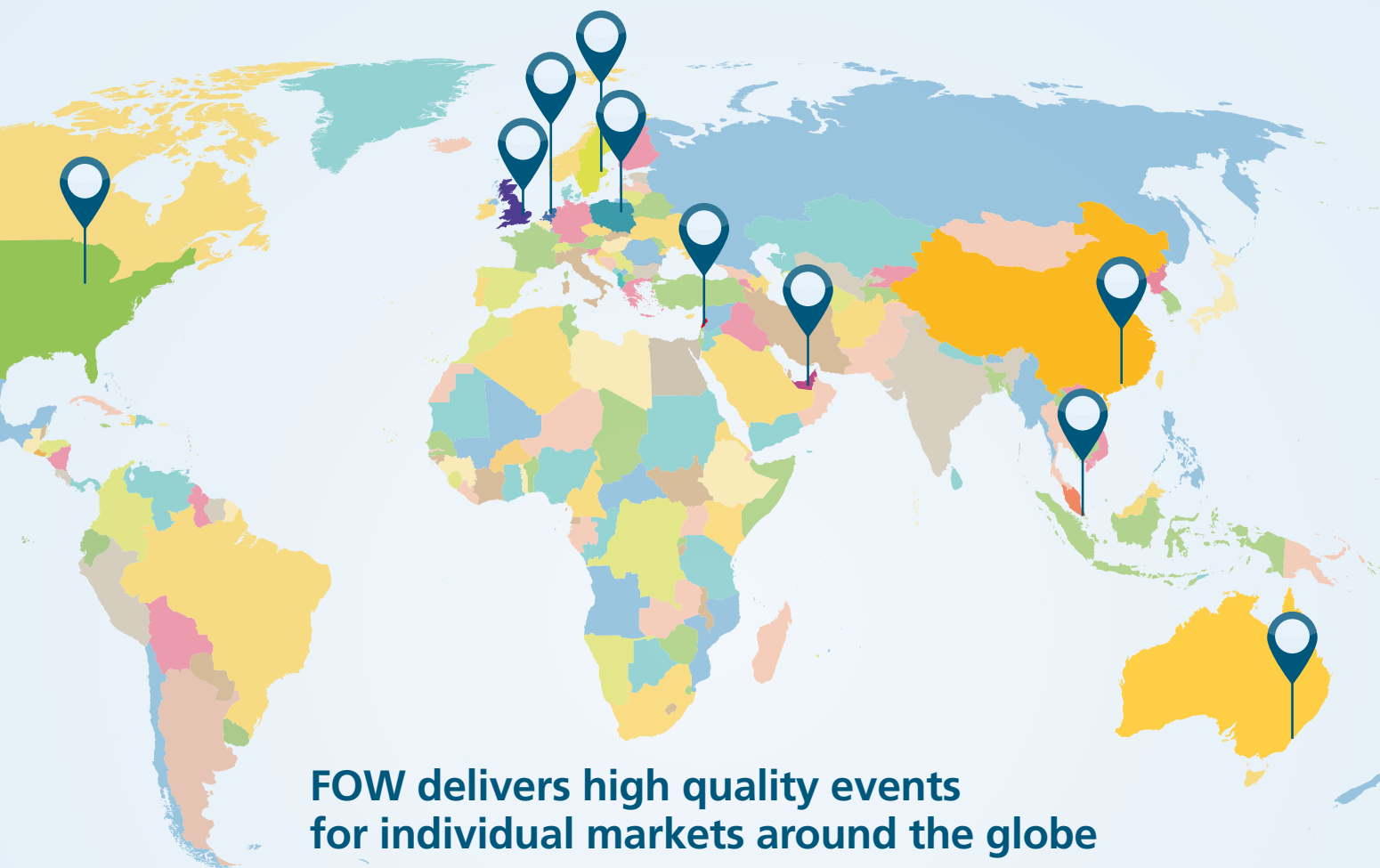
The Chicago Board Options Exchange (CBOE) on February 28 completed its acquisition of **Bats Global Markets** as scheduled and has outlined its new management structure. **Edward Tilly** will continue in his role as chairman and former Bats chief Chris Concannon will serve as chief operating officer. Of the 14 executive appointments, only four hail from Bats. Andy Lowenthal, the CBOE's senior vice president and head of business development has been put forward as the head of global derivatives. Lowenthal began his career with CBOE in 1983 serving in trading operations, regulatory services, strategic planning and business development roles.

COEX Partners, run by former Newedge futures head John Ruskin, has hired three senior brokers from Societe Generale in New York, marking the latest additions to the firm's US business. COEX has hired Rafael Hessmann, Daniel Zalewski and Eric Cuddihy, three relative value broking specialists who last worked at Societe Generale in New York. All three joined COEX in New York in the middle of January, according to the National Futures Association website.



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