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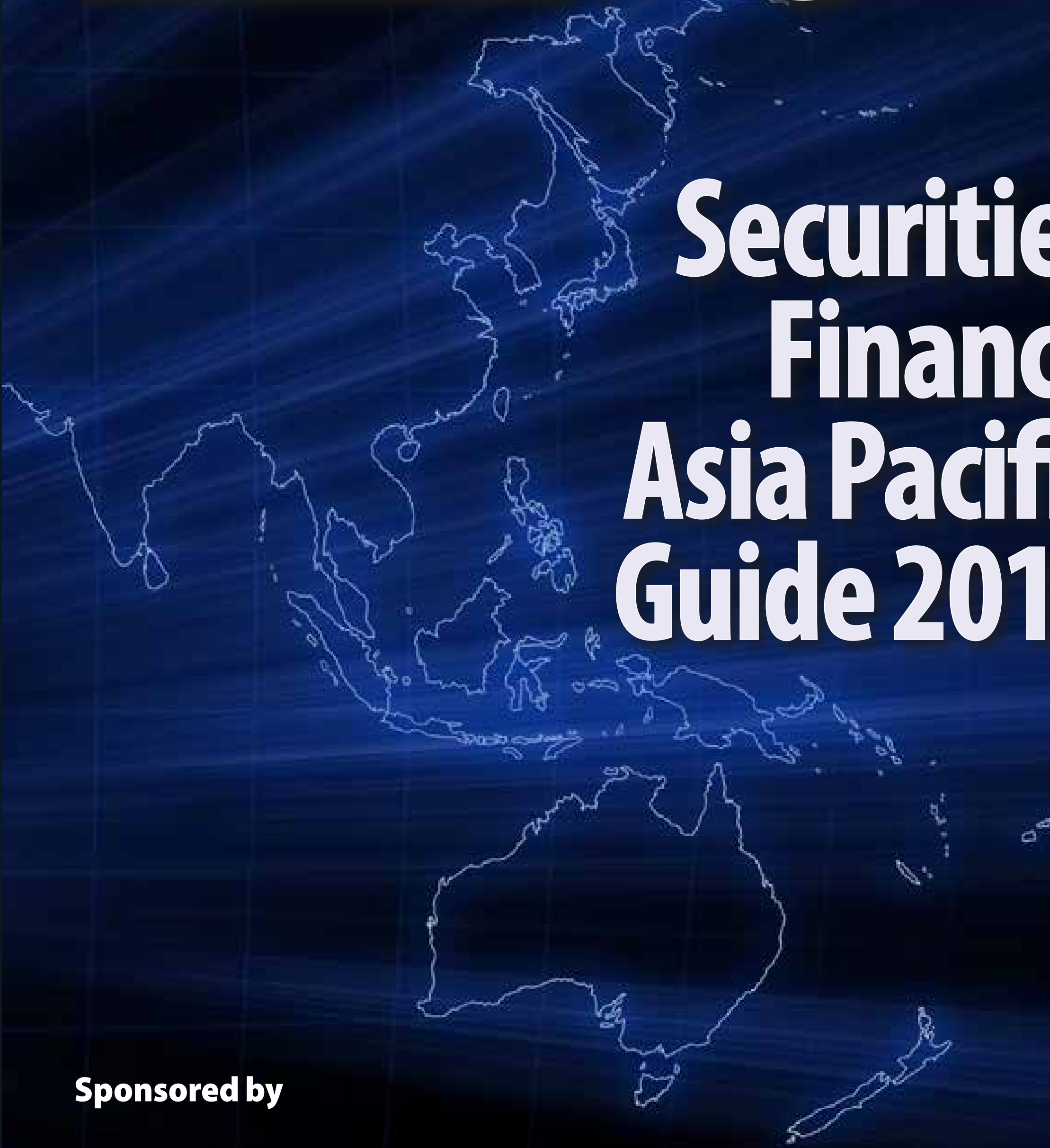

Securities Finance Asia Pacific Guide 2018

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Asian clients move to diversify strategies

Asian clients have shown a willingness to explore collateral options and work with other market participants to mitigate risk, writes *Paul Golden*

According to DataLend, collateral used when borrowing Asian securities is split approximately 20% cash – 80% non-cash collateral. Japanese government bonds are the main asset class for Japanese asset owners in collateral swap transactions, while core market government bonds such as US Treasuries are the standard when receiving collateral, explains Euroclear's head of product solutions – collateral management, Olivier De Schaetzen.

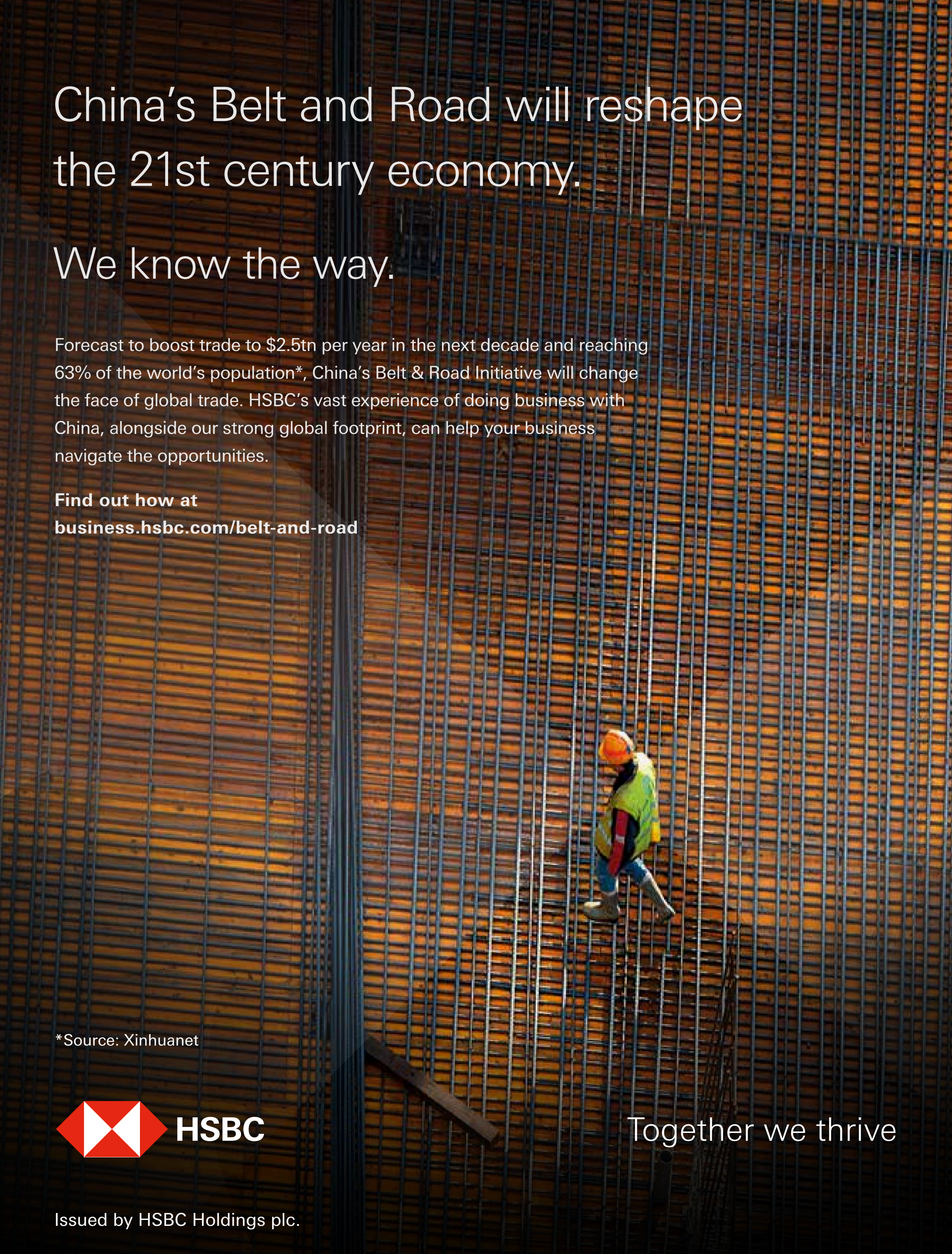
"Japanese government bonds are also widely used in liquidity driven transactions or over-the-counter derivatives margining," he said. "With negative rate level prevailing in Japan, there is a strong demand to optimise these bonds."

However, such collateral is relatively expensive for borrowers to 'carry' and/or finance and their preference is still for equities that they tend to naturally hold according to Paul Solway, managing director and regional head of securities finance Asia Pacific at BNY Mellon Markets, who adds that premium fees remain available for lenders who are able to accept main index, global equities which naturally command additional margin in order to protect any unforeseen market volatility.

Cash collateral remains the final option for lenders and it represents a relatively small proportion of aggregate pools of collateral for Asia, he said. "While some still have memories of cash re-investment losses back in 2008, a sensible and thoughtful mandate can provide not only safe (but also additional) alpha returns."

Asia Pacific lenders have been quick to take advantage of the opportunities arising from the regulatory changes – specifically Basel III – and were quick to approve taking equities as collateral said JP Morgan's global head of agent lending and collateral management, Ben Challice.

It makes sense that clients who have the best expertise in managing these assets have been early adopters, he continues. "Clients locally have also been keen to undertake term loans to extract additional value from their lending book as we helped them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understand the drivers of the trade and manage the risk/reward profile."

Whilst third party lending is less commonplace in Asia, eSecLending Europe head of business development, Simon Lee, refers to an uptick in interest in recent years as lenders explore alternative routes to market and expects this trend to continue through 2018 and beyond.

He also expects to see other aspects of the wider global securities lending industry become more familiar amongst lenders in Asia. These include:

- Increasing participation in securities lending programmes within the fund management sector
- In-house management of cash collateral to support other business functions
- Outsourcing of self-managed securities lending desks
- Use of both exclusive and discretionary trade structures as routes to market
- Increased use of peer-to-peer trades for both lenders and borrowers

Lenders globally look for security from their collateral, but given the high proportion of sovereign institutions acting as lenders in the region, it is especially true in Asia where high quality collateral such as AAA-rated sovereign bonds, US Treasuries and cash still dominate collateral schedules said Jansen Chua, head of securities finance Asia Pacific at State Street.

"While some still have memories of cash re-investment losses back in 2008, a sensible and thoughtful mandate can provide not only safe (but also additional) alpha returns"

Paul Solway, BNY Mellon Markets

With a prevalence of high quality liquid assets in their portfolios and a long term investment horizon, Asian asset owners are in a favourable position to benefit from changing demand dynamics driven by regulatory requirements and are increasingly exploring flexibility in collateral schedules and also considering alternative routes to market, adds Chua.

Zubair Nizami, head of global securities lending trading for Asia Pacific at Brown Brothers Harriman suggests a more relevant theme is the active versus passive debate in the investment manager space.

This has translated into significant changes in sentiment towards securities lending, with many ETF and passive fund providers not only engaging in securities lending but also acting as advocates, he said.

"This positive engagement has spilled over into the active managers' space as they look for different avenues for yield, thereby providing a healthy pipeline of new business. For a growing number of institutional investors, the

opportunity to offset fees with lending revenues is increasingly attractive."

Third party risk management tools have greatly enhanced the ability of lenders and borrowers to monitor risk in real time, said Sam Pierson, director IHS Markit Securities Finance.

"As beneficial owners look for additional revenue in markets where they may previously have not lent, the availability of risk monitoring tools is essential," he said.

Recent regulatory developments under the European Market Infrastructure Regulation (Emir) in Europe and Dodd-Frank in the US to reduce systemic counterparty and operational risk have not triggered similar requirements in Asian countries.

"For a growing number of institutional investors, the opportunity to offset fees with lending revenues is increasingly attractive"

Zubair Nizami, Brown Brothers Harriman

However, Brenda Bol, head of global funding & financing sales and relationship management for Clearstream notes that they are all following these rules and observe the impacts that such rules would create in their markets, which tends to infer that Asian risk appetite is less visible in this respect.

Following the financial crisis of 2008, many buy side clients either stopped lending or took much of the risk management decision making processes in-house. As the market has normalised it makes sense for lenders and their agents – as well as borrowers and their brokers – to work together to develop an optimal risk mitigating strategy that is right for the respective buy side clients.

Solway observes that all institutional borrowers and lenders, agents and brokers have invested heavily in their risk management personnel and systems and this heightened expertise is making the risk/reward profile of securities lending a much more palatable offering. As a result, beneficial owners and other asset managers are entering or re-entering into a viable securities lending programme.

"Clients tend to start with securities lending and then move onto more complex structures that fit within with acceptable risk and execution mandates," he said.

The perceived 'old-school' opaqueness of securities lending has all but disappeared, concludes Solway. "Regulation demands and technology facilitates greater transparency in the financial marketplace and securities finance is no longer an outlier. Instead it now plays an essential role in the liquidity lifecycle of Asian securities, both equities and fixed income."

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SECURITIES FINANCING

WeMatch plans big push in Asian lending

David Raccat, chief executive & founder at WeMatch. SecuritiesFinancing, said the nascent company is planning to expand this year its business on several fronts

Since launching his matching platform WeMatch in early 2017, its chief executive and founder David Raccat said the firm is poised to embark on a period of rapid growth, with a particular focus on Asia. London-based Raccat said WeMatch only opened to Asian customers in November last year and already there is a decent volume of lending in Japanese and Hong Kong names.

He is keen to avoid generalisations about a region as diverse as Asia, adding: "Asia is of course very different to the US or Europe. The region is fragmented and the different markets tend to be at different stages or levels of complexity."

Yet Raccat believes WeMatch's service, specifically that it enables clients to transact swaps, repo and loans in parallel, makes it a compelling prospect in Asia's main lending centres.

Raccat said: "WeMatch is unique also in that we show all the products in a single ecosystem, we are the only platform doing this."

He added: "The idea that we show swaps alongside repo and securities loans is something that Asian clients are very interested in because most have the ability to switch from one product to another. Asian also tends to be less siloed in terms of how the banks are structured."

Bank inertia has historically been one of the biggest barriers to the success of lending platforms like WeMatch but Raccat feels the industry is at a tipping point.

He said: "Personally, I would have been sceptical in launching this service five years ago but I think the window of opportunity is open now. If you look at the idea of making the market more transparent and more liquid, it's not a question of if, it's a question of when, and I think that "when" is now."

Raccat said the largest lending banks are among his customers – he said some 32 firms are using his platform and of these "about 70%" were banks and the rest are institutional investors. The platform is handling about 2,500 requests a day and receiving about $40bn of interests daily, he added.

He said: "For the banks, the platform looks at being fully adapted to and integrated with their internal systems which helps them tackle operational risk which frees up their balance sheet."

Raccat also plans to continue adding new products to the platform. "We have launched in November 2017 equity derivatives (exotic products) and plan to launch at the end of February 2018 a dedicated Delta One platform. It took us one year to build total return swaps, six months to deliver repo and securities lending, three months for equity derivatives and six weeks for Delta one."

Ultimately, the aim is continuing increasing the levels of business being transacted on the ambitious platform. "We want to reach a target of 50 legal entities with about 350 users and I think that is achievable by the end of June," concluded Raccat.

Market infrastructure challenged by regional diversity

The sheer diversity of Asia's securities lending markets presents an ongoing challenge for all market participants, reports *Paul Golden*

Markets across Asia are at different stages in terms of having the systems in place to support securities lending. Tokyo, Hong Kong, Singapore and Australia are well developed, whereas markets such as Korea, Taiwan, Thailand and Malaysia are not as well established and have some more bespoke requirements.

According to Andrew McCardle, director, head of EquiLend Asia, there is always an appetite for growth in Asia and it seems to be more a case of which market will be next and how will it work.

"It would seem that there is a much greater potential for markets the size of India and China, but with size comes a much larger effort for firms to become established," he explains. "Even for fintech firms, it is a case of whether they can bring their global standards and flows to these markets as they emerge. For those larger markets, technology will become of greater importance."

Securities lending volume and activity tend to be in line with relative market capitalisation – in other words, the world's largest stock markets tend to correlate very closely with relative securities lending rankings. As such, China and India are outliers as substantial markets on a capitalisation basis, but where securities lending activity is under-sized or not accessible by non-residents observes HSBC's global head of securities lending, Roy Zimmerhansl.

"As such, they hold incredible potential for beneficial owners as and when regulators allow better access for securities lending and borrowing," he said.

Ben Challice, global head of agent lending and collateral management JP Morgan, said there is undoubtedly significant interest. "However, we also need to see the primary markets open up in these jurisdictions first," he adds. "Assuming that happens, if and when these markets then begin to support an off shore securities lending product, the potential is vast."

China is very interested in setting up a collateral management infrastructure inspired by the successful models that exist in Europe and the US, adds Olivier De Schaetzen, head of product solutions – collateral management at Euroclear.

Olivier De Schaetzen, Euroclear

The aim of this infrastructure would be to facilitate the development of a fully-fledged local triparty market in China, where Chinese government bonds become the primary collateral asset class, in the same way as US government bonds are used across the world today.

However, Zubair Nizami, head of global securities lending trading for Asia Pacific at Brown Brothers Harriman, said that from an offshore standpoint, the Chinese and Indian markets are some time away from being of interest to its clients.

"In India, restrictive parameters around loan tenures, collateral requirements and other operational areas are challenging and won't do much to change our view," he continues. "That said, we are hearing of interesting discussions taking place between some market participants that may pave the way to further reforms. The size and scale of the Indian economy makes for significant potential in the long term, although wholesale changes to some aspects of the existing securities lending model will be needed in order for that to be realised."

Nizami suggests that the Chinese market is at something of an impasse. Technically, there is a model for offshore holders of A-Shares to lend their securities via the Stock Connect scheme, but its use remains almost non-existent due to various restrictions that curb both lending supply and end user demand.

"In the short term we are not optimistic that much will change," he said. "However, in the longer term, as China looks to further liberalise its capital markets we expect the relevant authorities will look to enact further reforms to the current model in order for a more scalable model for offshore investors to emerge."

Brenda Bol, head of global funding & financing sales & relationship management for Clearstream, adds that despite having to tackle challenges such as unharmonised short selling rules, stamp duties and mandatory buy-ins, market players increasingly have to focus on collateral. Collateral requirement has shifted from cash towards high quality fixed income securities and infrastructure providers have come up with different solutions – including triparty collateral management services – to support such growth.

Stock markets in China are the second largest in the world and its index futures and stock loan market have experienced significant growth over the past decade. However, it remains primarily a domestic market, said Bol.

"We are starting to see the market looking more closely at China opportunities and aspirations to use Chinese bonds as collateral. This also includes the development of new international links such as the setting up of the China Europe International Exchange in Frankfurt."

Paul Solway, managing director and regional head of securities finance Asia Pacific at BNY Mellon Markets, notes that the MSCI Emerging Markets Index began adding China A-shares last June, making long exposure a reality for both active and passive international investors.

"Unfortunately the short side of the equation is still limited to domestic qualifying entities," he said. "However, the vibrant lending activity in H-shares (Chinese securities listed in Hong Kong) is evidence of the appetite for short exposure to A-shares."

Simon Lee, eSecLending Europe

Beyond the region's two largest economies, head of business development for eSecLending Europe, Simon Lee, notes that regulators in the Philippines and Indonesia are also looking at the potential to open up securities lending in their respective markets, albeit under varying timelines.

Automation has made significant progress in Asia over recent years and with quantitative and algorithmic funds becoming more prevalent, speed and scale of execution is paramount to buy side clients trading thousands of securities across multiple markets on a daily basis.

Whilst many institutions continue to invest in their own internal technology, the next iteration of market efficiency will depend on connectivity with exchanges that may have differing execution criteria across their respective markets, concludes Solway. "Therefore, data aggregation is becoming even more important in order to allow investors to execute transactions in a timely manner."

Asia grapples to harmonise regulatory structures

A flexible approach is vital when navigating the disparate regulatory structures governing securities based lending in Asia, writes *Paul Golden*

It is important to recognise that Asia is comprised of many different countries and markets, each with their own national priorities and expectations and at differing stages of development from a securities lending point of view. As Roy Zimmerhansl, global head of securities lending at HSBC, notes, there are many examples of different rules for capital raising, short selling and corporate actions.

Simon Lee, managing director, head of business development for eSecLending Europe observes that despite the differences in rules and regulations – as well as operational nuances – the majority of developed markets in Asia operate under similar structural frameworks. "As regulators look to facilitate lending in new markets, we see certain similarities in their approach and proposed frameworks."

In markets where the framework to support securities lending may be described as 'non-standard' and where there may be additional operational, regulatory or other considerations to take into account, lenders will assess the revenue opportunity open to them in lending in that market. They will then make a decision to lend or not based on the goals and objectives of their securities lending programme, alongside their broader investment strategy and activities in that market.

Regulation continues to be a major consideration impacting demand and supply dynamics. Balance sheet and capital efficiency (driven by regulatory requirements) remains a top priority amongst borrowers and this has translated into rising borrower demand for high quality liquid assets such as sovereign debt (whilst asset demand across the industry has generally been declining post global financial crisis) and an increasing preference for exposure to lenders with flexibility in collateral requirements and preferential risk weighted asset weightings.

That is the view of State Street's head of securities finance Asia Pacific, Jansen Chua, who adds that this potentially presents opportunities for lenders to extract incremental value and greater loan balances within the context of a risk adjusted return analysis.

One of the key issues in the current global financial landscape is collateral fragmentation and the related challenges of mobilising assets held in one market and using them as collateral to cover exposures in another, said Clearstream's head of global funding & financing sales & relationship management, Brenda Bol. This has forced banks to leave pools of collateral in each of the markets in which they operate, leading to inefficiencies.

"Low touch mature securities lending markets – such as Australia and Japan – are similar in their operating models and are significantly different to markets such as Taiwan"

Donato D'Eramo, RBC Investor & Treasury Services

In Europe, T2S can be seen as a way to harmonise settlement processes across the eurozone, she continues. "However, global markets also require solutions. The US and Japan, for example, remain important pools of collateral for which T2S cannot provide a solution. It is therefore up to other market infrastructure providers to work on solutions to overcome this global challenge. Improvement of market links and partnerships with other Central Securities Depositories are key to providing market participants with efficient ways to mobilise assets, thus reducing the need to create buffers to compensate operational inefficiencies."

One of the many consequences of the evolving regulatory landscape is a continued increase in the number of collateral swap transactions, suggests Olivier De Schaetzen, head of product solutions – collateral management at Euroclear.

For example, beneficial owners looking to efficiently invest their portfolio in a secured way are now lending their US Treasury bills and European or Australian government bonds in exchange for Japanese government bonds – or lending Japanese government bond in return for a wide range of collateral options, he said.

"Because of regulatory requirements, Asia is also becoming more connected to the global collateral management community where all sizeable actors of the over-the-counter (OTC) derivatives world are, or will soon be, required to exchange margin.

Until now, firms active in the OTC world have always preferred to receive high quality securities collateral as initial margin. As margin volumes increase, the demand for high quality assets is also rising which in turn is driving up securities lending activity in Asia as firms increasingly turn to collateral swaps to tap into the pool of high quality assets."

Despite Asia's regulatory fragmentation, it is not unreasonable to expect the gradual convergence of securities lending rules over time suggests Dane Fannin, head of capital markets Asia Pacific at Northern Trust.

"Asian economies are all developing at a different pace and hence regulators will have differing priorities in respect of their ability and willingness to make changes to securities lending rules that align with a standardised model. However, if one observes the overarching regulatory trends out of other major hubs and recognises that ultimately there are clear benefits for the market and for participants in the pursuit of greater standardisation, it is reasonable to expect Asia to follow this trajectory."

Brenda Bol, Clearstream

Potential benefits of harmonisation are better performance and efficiency for the market. Paul Solway, managing director and regional head of securities finance Asia Pacific at BNY Mellon Markets notes that PASLA is working with the Asia Pacific Financial Forum, which in turn is developing a roadmap for APEC finance ministers to improve the region's financial market infrastructure through improved connectivity and interoperability across the Asia Pacific markets. Securities lending and repo is just one of many streams that the Asia Pacific Financial Forum has developed.

"Intermediaries such as agent lenders and prime brokers are employed to facilitate, empower, advise and protect their respective buy side clients, which is why continued education of products and market nuances is so important," he adds.

"Likewise, industry bodies such as ASIFMA, PASLA and AIMA all have an advocacy role to play across mature and emerging markets alike across Asia in order to continue the pursuit of best market practice."

However, RBC Investor & Treasury Services's managing director, global head of securities lending, Donato D'Eramo, said harmonisation is unlikely in the near term. "Low touch mature securities lending markets – such as Australia and Japan – are similar in their operating models and are significantly different to markets such as Taiwan where a local intermediary is required to conduct business," he concludes.

Non-European firms face SFTR fall-out

Paul Landless runs the financial markets team for Clifford Chance in Singapore and South East Asia

Post implementation of Mifid II (January 3 2018), financial markets participants will start to engage more fully in addressing the reporting requirements of the EU Securities Financing Transactions Regulation (SFTR), which came into force on January 12 2016 (although many of its requirements are subject to transitional provisions). The SFTR is integral to the European Commission's strategy to reduce perceived 'shadow banking' risks in the securities financing markets and forms part of the EU's response to the Financial Stability Board's August 2013 policy proposals on Securities Lending and Repos. This article outlines the key extra-territorial features of the SFTR and discusses some of the issues for the global market as it prepares for implementation.

Disclosure of and consent for reuse

Article 15 of the SFTR, which came into effect on July 13 2016, lays down new requirements for the reuse of securities and other financial instruments provided as collateral under all security and title transfer collateral arrangements. As a result, the scope of Article 15 extends beyond SFTs to cover, for instance, financial instruments collateral provided in respect of derivatives transactions. The definitions of 'security collateral arrangements' and 'title transfer collateral arrangements' follow those in the Financial Collateral Directive, but apply regardless of the nature of the obligation secured.

Article 15 applies to a broad range of counterparties – defined to cover any 'undertaking' established in the EU – that receives collateral with a right of reuse. This potentially includes even situations where a counterparty receives collateral from individuals that do not qualify as an 'undertaking'. It applies to counterparties established in the EU, even if they are acting through a branch outside of the EU.

Article 15 also applies extraterritorially – i.e. to non-EU counterparties – although only if these counterparties are receiving collateral from counterparties established in the EU, or where a non-EU counterparty is acting through a branch in the EU. There are limited exceptions to this rule, and counterparties receiving collateral from exempt entities must still comply with the reuse requirements. Article 15 stipulates that all counterparties – not just financial intermediaries – will have the right to reuse financial instruments received as collateral under a security or title transfer collateral arrangement only if the following conditions are fulfilled:

Disclosure of risks and consequences: the providing counterparty must be duly informed in writing by the receiving counterparty of the 'risks and consequences' that may be involved in (i) giving consent to a right of reuse under a security collateral arrangement or (ii) concluding a title transfer collateral arrangement; and

Article 15 applies to a broad range of counterparties – defined to cover any 'undertaking' established in the EU – that receives collateral with a right of reuse

Prior express consent: the providing counterparty must have (i) 'granted its prior express consent, as evidenced by a signature in writing or in a legally equivalent manner to a security collateral arrangement which provides a right of use of collateral,' or (ii) must have 'expressly agreed' to provide collateral by way of a title transfer collateral arrangement.

Additionally, the SFTR stipulates that the exercise of any right of reuse must be undertaken in accordance with the terms of the collateral arrangement and financial instruments received under a collateral arrangement must be transferred from the account of the providing counterparty. There is still some uncertainty around how to satisfy this requirement. However, at least where the receiving counterparty acts as custodian for the providing counterparty, it seems likely that the client's account should indicate that securities have been transferred from that account if and when they are reused. The SFTR alternatively provides for reuse to be evidenced by 'other appropriate means' if third country counterparties are involved in the transaction and are subject to the laws of that third country.

Reporting requirements

The reporting regime under the SFTR applies to counterparties established in the EU, including their non-EU branches, and to the EU branches of non-EU counterparties. Non-EU counterparties may be indirectly impacted when they transact SFTs, as the reporting entities will require to obtain certain information in order to fulfil their reporting obligations, including the Legal Entity Identifier of their counterparty.

The reporting regime follows the model for derivatives reporting under the European Market Infrastructure Regulation (Emir), and stipulates that both parties to a trade must report new, modified or terminated SFTs to a registered EU or recognised non-EU trade repository by T+1, and must maintain records of SFTs for at least five years following the termination of the transaction. Additionally, counterparties must report the associated collateral to the trade repository, either by T+1, or on value date + 1, according to the method of collateralisation adopted.

The reporting obligation is phased in by counterparty type. The European Securities and Markets Authority (Esma) is required to produce regulatory technical standards (RTS) setting out further detail on the reporting obligation. Once those RTS come into force, banks and investment firms will have a 12-month grace period until the reporting obligations apply; meanwhile, central securities depositories and central counterparties will have a 15-month transitional period; other financial counterparties (including UCITS and AIFs), an 18-month period; and, finally, non-financial counterparties, a 21-month period.

However, where implementing legislation was previously expected to come into force by Q1 of 2018, the final RTS is still awaiting approval by the EC and the European Parliament, and is presently expected to enter into force during Q2 of 2018 instead. As a result, we do not currently expect the reporting obligation to start until 2019.

The SFTR is the latest in a series of wide-sweeping regulatory initiatives affecting securities financing markets and collateral, both within and outside of the EU

Implementation

The SFTR is the latest in a series of wide-sweeping regulatory initiatives affecting securities financing markets and collateral, both within and outside of the EU. Although less extensive than other recent regulatory reforms, most notably Mifid II, the SFTR nonetheless presents significant compliance challenges. At the core will be identifying in-scope entities and transactions, which may require systems build and establishing internal processes, e.g. to capture all new in-scope collateral arrangements. Market participants will need to integrate their implementation project for the SFTR, and monitor developments, as the full implementation of the SFTR draws closer.

Paul Landless specialises in structured finance, derivatives and financial markets products, including securitisations, repackagings, structured notes, securities lending and repo. He leads the financial markets team for Clifford Chance in Singapore and South East Asia. Miles Binney, senior associate, Singapore and Caroline Dawson, senior associate, London, also contributed to this article.

Hong Kong's review: how to prepare

By Greg Heaton, senior consultant, Timothy Loh LLP

On October 30 2017, the Securities and Futures Commission (SFC) announced a thematic review on prime services and equity derivatives. Thematic reviews often result in changes to regulations and, for individual firms, may result in compliance advice letters requiring changes in operating practices or, more ominously, enforcement action. In this article, we explore possible reasons for this review, provide our perspective on how this review may affect the industry and offer suggestions on how to handle the review.

In its circular dated October 30, 2017, SFC announced a thematic review on prime services and equity derivatives activities with the objectives of (i) identifying potential conduct issues arising from prime brokerage practices, (ii) assessing internal controls in place, and (iii) providing guidance on how risks are managed.

What to expect

The review is likely to result in clarifications to regulatory conduct expectations, which will likely to be expressed through changes to the Fund Manager Code of Conduct, as foreshadowed in the SFC's November 2016 Consultation Paper on Proposals to Enhance Asset Management Regulation and Point-of-sale Transparency. Although the SFC has characterized these as high-level principles-based proposals, they include some prescriptive expectations in relation to matters such as custody arrangements, liquidity risk management controls, collateral valuation policies for securities lending, and disclosure of leverage. From the prime brokers' perspective, these and other requirements imposed on fund managers will impact the services that prime brokers are expected or able to provide to their fund and fund manager clients.

Preparing for an inspection

Prime brokers should now prepare for SFC requests for information and on-site inspections. Demonstrating preparedness and cooperation can go a long way to dampening an inquisitive inspector's ambitions for finding anything untoward within your firm, and encouraging them to devote their energies to targets elsewhere.

Centralizing communications

To maximize efficiency and consistency, firms should be ready to appoint a contact person who can receive requests from the SFC for information or meetings. The person should be an employee who is familiar with the firm's policies and procedures, although they cannot alone be responsible for answering the SFC's questions. Rather they will need to direct the requests to appropriate individuals within the firm, if necessary after seeking clarification from the SFC to understand exactly what they are looking for, and then coordinate responses.

Control of information flow

Responses to SFC requests should be truthful and concise and, where appropriate, supported by relevant records or other documentation. The employee responsible for coordinating responses should check through documents before they are provided to the SFC, to ensure their relevance and to identify any possible areas of control weakness. They should keep a record of what documents have been provided and who the SFC has spoken to.

Setting the scene

A firm should also identify individuals within its senior management who can attend an opening meeting with the SFC, at which the company should be prepared to present the SFC an overview of its operations as well as its risk management and compliance monitoring protocols. Senior management should also be available to deal promptly with any surprises that may arise during the inspection. Finally, they should seek to schedule a closing meeting with the SFC. This will present an opportunity to probe the SFC for preliminary comments, particularly any possible areas of concern, and to try to resolve all outstanding issues before the SFC prepares its findings.

Evaluating possible weaknesses

Firms should also try to anticipate what documents the SFC is likely to request, such as the firm's compliance manual, internal control procedures, business plan, organization chart, client service agreements and product documentation. They should consider whether there are any problematic issues that the SFC might ask about.

The SFC has endeavoured to frame this thematic review as a positive opportunity for prime brokers to share their views on existing regulatory requirements. But SFC enquiries and on-site inspections can quickly become a significant imposition on staff time and company resources. Moreover, it is inevitable that the SFC will strive to identify weaknesses within particular firms, as well as across the industry. This will likely lead ultimately to the SFC issuing compliance advice letters to some firms, and potentially in some cases to commencement of disciplinary action.

Timothy Loh LLP is an internationally recognized Hong Kong law firm focused on mergers & acquisitions, litigation and general financial markets and financial services matters.

Technology is changing the face of securities finance in Asia

Technology is exerting a growing influence on many aspects of securities based lending business in Asia, finds *Paul Golden*

Technology is increasingly the solution to improving liquidity and transaction execution where there are market-specific requirements that place additional requirements on securities lending market participants, such as the hold requirements in Hong Kong. That is the view of Roy Zimmerhansl, global head of securities lending at HSBC, who adds that while IT vendors clearly play a role in market efficiency, the greater impact in an over-the-counter market such as securities lending comes from how users of the technology deploy the applications.

"Our view is that we use technology to automate routine functions with a focus on speed of response and accuracy," he explains.

"There are two primary objectives behind this. The first is that fast, comprehensive and correct responses to borrower requests is essential to retain and grow market share in a business that is increasingly dominated by automated execution. The second is to give traders more time to work on non-standard, complex trades and develop counterparty relationships."

Transparency around programme performance is a key area for technology. The ability to automatically consume information from data vendors can enable firms to quickly identify the intrinsic value of securities and portfolios explains Martin Seagroatt, marketing director for securities finance & collateral management at Broadridge, a technology firm.

"This is one area where technology can provide a clearer link between a firm's holdings and their market value," he said. "This leads to a need for greater internal transparency around the firm's global inventory and exposures. Once again, this is assisted by technology that allows the firm to bring this inventory to market or deploy it as collateral more effectively."

All of this can be facilitated by greater visibility of the external securities finance and collateral ecosystem, which includes tri-party agents, collateral exchanges, peer-to-peer platforms and electronic trading platforms. This of course, requires a degree of connectivity and straight-through processing between a firm's systems and market infrastructure.

"We are now seeing lenders across the region using targeted availability to send out not just what they have available to lend but also the cost of borrowing those securities"

Andrew McCardle, EquiLend Asia

Finally, regulatory reporting mandates are only going to become more prevalent, said Seagroatt. "In Asia, regulators may have a desire to align with the Financial Stability Board's shadow banking rules and reporting initiatives such as Securities Financing Transactions Regulation (SFTR). Technology solutions with strong transaction reporting capabilities are therefore essential."

IT vendors have a role to play in promoting more efficient trading strategies according to Seagroatt, taking in data from multiple sources and using that information to think more strategically about trading opportunities and resource allocation.

Automating manual processes also frees up time for decision-making, he added. When traders and operations personnel are no longer spending so much of their day on time consuming manual processes, they can turn their attention to process optimisation, efficiency gains and P&L generation.

Donato D'Eramo, managing director, global head of securities lending RBC Investor & Treasury Services, is in agreement on the importance of the role of vendors, noting that EquiLend's Next Generation Trading (NGT) platform continues to gain traction in Asia.

Such platforms not only promote more efficient trade execution, but also promote transparency across the industry, he said. "As we bring more efficient routes to market for our lenders and more efficient trade execution for our borrowers, we continue to invest in the technology behind our securities lending programme."

According to Andrew McCardle, head of EquiLend Asia, technology is enhancing transparency in the Asia Pacific securities finance market in two ways.

"Products such as DataLend offer clarity into the market that is not available anywhere else," he said. "This is especially true in Asia, where in some markets the ability to distinguish fee differentials between onshore lenders and offshore lenders is crucial, as the cost can be quite different. Additionally, with the move to embrace our NGT trading platform in Asia, we are now seeing lenders across the region using targeted availability to send out not just what they have available to lend but also the cost of borrowing those securities."

"Low touch mature securities lending markets – such as Australia and Japan – are similar in their operating models and are significantly different to markets such as Taiwan"

Dane Fannin, Northern Trust

There is a distinct role that IT vendors play in the pursuit of more efficient trading strategies, which is perhaps more pronounced within securities finance given the inherent reliance on bilaterally negotiated transactions, said Northern Trust's head of capital markets Asia Pacific, Dane Fannin.

Trading teams have long since advocated the need for enhanced trading platforms that allow for enhanced automation to free up capacity and focus on value-added opportunities for clients, he continued. "The ability to innovate a scalable solution bilaterally has always been a challenging proposition given the myriad of unique requirements at each counterpart. However, vendors have seized the opportunity to provide centralised technology that allows participants to integrate into their proprietary systems to achieve better results."

Vendors have also played an important role in the provision of market data, which has been a key driver in promoting increased transparency, ultimately lowering costs and improving performance for clients. The proliferation of data has allowed trading teams to better measure the relative success of trading strategies and with near real-time data, allows for the timely adjustment of strategy to ensure a successful outcome.

"As the tools available to analyse data advance, it will be interesting to see the extent to which firms are able to innovate and leverage this data as a competitive advantage for clients," said Fannin.

Northern Trust believes that technologies such as distributed ledgers, data analytics, artificial intelligence, robotics and cognitive computing will facilitate an evolution across the broader securities services industry within the decade, delivering real value to the business and its clients.

It is entirely plausible that the potential benefits – including increased operational efficiency, greater transparency and enhanced risk management – would also impact securities finance positively and indeed we are already starting to see the emergence of drivers that demand such change, adds Fannin.

"It is clear that the end users of borrowed securities are increasingly adopting innovative technologies into their investment decision-making processes which are likely to reshape the securities finance value chain in years to come. The rise of quant funds which seek to deploy algorithmic based investment approaches demands a greater level of autonomy and reduced latency of execution, which requires increased efficiency in the ability to source and borrow stock."

The drive for transparency has really been fuelled by the significant shift towards online accessibility of real time data

Technology is essential for transparency, but the drive for transparency has really been fuelled by the significant shift towards online accessibility of real time data that has been made in recent years by global custodians, suggested Natalie Floate, head of market & financing services (MFS) APAC at BNP Paribas.

Lenders in Asia Pacific tend to view their securities lending activity in line with their core investment activities by default, expecting the same level of visibility of the activity as they have from their general custodial activities, she adds.

"As these have advanced, their use of the data in-house has advanced in terms of consolidation, upload or integration within their own systems, risk management and monitoring frameworks and governance. Thus, lenders have an expectation that their securities lending services should have this same level of service – online, real time and the ability to access not just predetermined reports but also data. Transparency has led to integration and raised securities lending activities from being a background activity to being fully incorporated into our lenders with our own general investments operations and reporting," Floate said.

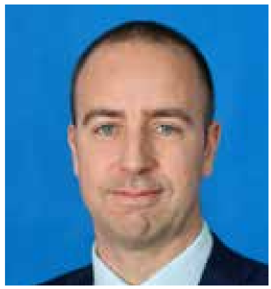
While vendors are expected to add value in areas such as data sourcing, flexibility, matching and automation, it is essential to have a trading lens to see the opportunity and context it in terms of credit, risk, balance sheet and those elements that go beyond pure market dynamics, concludes Floate.

Asian demand for synthetics stays strong

The ability to lend across a range of markets – both from a stock loan and a synthetic perspective – is a major advantage for Asian securities based lending market participants. *Paul Golden* reports

Adam Smith, head of equity finance trading, equities, Asia Pacific at HSBC observes that synthetic options are frequently used in Asia to offer market access to clients in countries that don't have a stock lending framework. "More so, however, and due to the fragmented nature of the Asian markets, many institutional clients utilise the synthetic route in order for their prime or synthetic-prime broker to manage the operational and regulatory complexity of the many different markets on their behalf," he said.

"The volume of synthetic trades involving markets that do not have a functioning stock lending framework is a small percentage of total transactions, but this is somewhat driven by the lack of supply."



Adam Smith, HSBC

There is significant interaction between securities based lending, repo and synthetics, all of which are used extensively in the region whether the objective is market access or financing.

With Asian equities becoming more widely accepted as collateral and increased pressures on balance sheet due to regulatory leverage and liquidity constraints, Smith describes equity financing in the region as a real growth story.

"As equities treatment under the LCR and NSFR rules are fairly punitive it is crucial for many brokers to be able to refinance their positions in order to optimise their balance sheet," he explains. Whether the solution is synthetic or via stock lending will be driven by factors such as the availability of a stock lending market, the cost of stamp duty on equity hedges and the regulatory framework of the markets in which they are acting.

Being unable to offer synthetic solutions in Asia does limit the utilisation that a lender might be able to achieve from a diversified Asian portfolio. However, the markets where stock lending is not available currently account for a relatively small percentage of the regions flow.

"This may be partially to do with the lack of a stock lending infrastructure which does help bringing liquidity to the market, but in general the impact is small," adds Smith. "However, due to a lack of supply in these markets, the lenders with inventory available synthetically benefit from much wider borrow spreads than those found in the more liquid securities based lending markets."

When asked which types of borrowers are attracted to synthetic solutions, he notes that brokers will look to synthetic solutions as a way of sourcing inventory that may not be available via stock lending avenues, but also increasingly as a balance sheet optimisation tool.

"In addition, institutional clients in many Asian markets often prefer to trade through a synthetic solution due to the operational and regulatory complexity of the region," continues Smith. "Brokers may also offer competitive financing rates to encourage the client to trade synthetically if the broker has counter flows which it can net off."

Jansen Chua, State Steet

State Street's head of securities finance Asia Pacific, Jansen Chua, notes that the region's emerging markets are seen as the next growth opportunity for securities lending participants, although the ability to monetise remains tied to key issues as such investor demand, developments in the local regulatory environment and the establishment of market infrastructure.

"Indonesia, the Philippines, Vietnam and Cambodia are markets which attract demand interest, but supply is constrained by the lack of a regulated securities lending market which pushes borrowers towards synthetic solutions in the interim," he said. "China and India are perhaps viewed as the key growth markets in Asia Pacific with significant opportunities for both borrowers and lenders alike. Whilst there have certainly been positive developments in recent years, there still remains a need for market infrastructure and a regulatory environment that would support securities lending activity."

Brenda Bol, head of global funding & financing sales & relationship management for Clearstream explains that beneficial owners – including central banks and sovereign wealth funds – are participating in the securities lending markets via traditional securities based lending/agency lenders and also utilising repos to loan out securities.

"As the bulk of these trades are collateralised by cash and some are covered by agency lender indemnity, it creates balance sheet burdens amid implementation of Basel III," she adds. "We have seen lenders being approached by broker/dealers to convert some parts of these cash-based securities loan trades into synthetics in order to reduce balance sheet consumptions – for example, turning a stock loan into total return swaps."

Globalisation of fixed income securities lending

Paul Collard, Head of Fixed Income Lending, Deutsche Bank Agency Securities Lending

There can be little doubt the fixed income lending market of 2016 and 2017 has been one of the strongest we have seen. Demand for bonds is at record levels as quantitative easing programmes and changing regulations reduce supply and increase demand for this crucial asset class. Many holders of fixed income securities are enjoying high levels of return, but unfortunately not every lending agent, lender or client has seen these results. One of the prime reasons for this is down to what we would call "the globalisation of fixed income lending".

To truly maximise returns and utilization levels, lenders and lending agents need to do more than simply focus on covering the globe with a network of trading locations where independent desks trade in their own local market. What is needed is a truly global approach, where bonds and collateral move around the globe under the control of a single, global lending business.

Quite simply, beneficial owners participating in agent lending programmes should expect to generate maximum intrinsic value for the bonds held in their portfolios, no matter where they are located. At the most basic level, this means making certain any client held securities are lent into their normal lending market (e.g. Italian govies into Italy), no matter where that client sits.

But it can also mean much more than that. It means having the expertise to move securities away from that natural lending market, and transferring them to the location that can achieve the highest spreads and overall returns. For example, lending Australian securities to borrowers based in Europe, lending European government bonds into Asia or even lending US Treasuries to borrowers based outside the US; whatever it may mean, bonds need to move to where there is the best demand and the best fit of collateral.

This demand comes in a vast array of shapes and sizes, and in many different combinations, so global lenders need to be agile, shifting their clients' bonds to the market where demand is highest and the available spreads are the widest. Collateral flexibility is key, as is operational expertise, but by moving securities to the best market, clients can achieve much higher returns.

Of course, this is a double-sided operation. It certainly involves the lending of client holdings, but it also means looking to settle collateral on the same global basis. To be a truly efficient and global business, agent lenders need to put securities on loan in one market, against the settlement of collateral on the other side of the world. This has to happen in a timely, efficient and risk free manner. Done well it allows lending teams to seek the best demand for their clients' holdings then moving those same securities elsewhere as the market demand shifts and adapts, and spreads and demands change.

Only through appointing a genuinely flexible, global lender of fixed income securities can a client be sure of achieving the full potential of the bonds they hold, and receiving the high level of value their portfolios contain.

No such thing as 'one size fits all'

Broker dealers continue to focus on optimising balance sheet, and most are looking to define collateral allocation parameters and develop their own algorithms, writes J.P. Morgan

When it comes to collateral, control is paramount – but how you define control depends upon your role. For example, borrowers want to be able to define optimal collateral allocation to address specific binding constraints, while lenders want access to more real-time reconciliation and automated processing of collateral schedules

These were just some of the takeaways from a series of client roundtables hosted recently by J.P. Morgan in Hong Kong and Sydney, where collateral counterparts came together to discuss the local, regional and global factors influencing their financing and collateral decisions.

For broker dealers, these factors include the potential for more balance sheet decentralization, which could result in more financing being done directly by Asia Pacific entities. Lenders, meanwhile, saw the value of on-loan assets (and related collateral) rise during 2017, driven by underlying market strength. While noting that significant work has been done to manage against capital requirements (with strategies that vary from firm to firm) and deploy assets more efficiently, participants agree there's still more opportunity as markets continue to evolve.

The discussions converged on three key themes:

A flexible toolkit to meet individual firm requirements

Each institution is managing to its own unique mix of legal entities, regulatory oversight and binding constraints related to capital. Broker dealers continue to focus on optimizing balance sheet, and most are looking to define collateral allocation parameters and develop their own internal algorithms. Being able to make optimization recommendations to a collateral agent is a critical factor in adhering to capital requirements.

Borrowers and lenders also seek flexibility and agility in managing collateral schedules. For them, online tools support speed of execution and provide welcome transparency: collateral providers can employ real time queries to learn which counterparties can accept their collateral, while collateral receivers can monitor and adjust their eligibility criteria at a granular level based on their firm's parameters.

Access to markets and structures to manage financing and liquidity

For institutions operating in Asia, regulatory change has heightened the focus on being able to fund their activities locally and efficiently. In Taiwan and Korea, a successful framework has been developed that lets broker dealers mobilize once 'trapped' assets, using tri-party structures to deploy them onshore. Options such as total return swaps, e.g., the use of derivative trades for securities financing, could be used to derive additional balance sheet and capital benefits. Other markets such as the Philippines and Indonesia are exploring the use of tri-party structures to unlock liquidity.

New markets continue to spark interest, particularly China (with A Shares due to join the MSCI by mid-2018). Banks' underlying clients, particularly hedge funds, are eager to hedge and want access to single stock swaps. Given the level of interest in China, borrowers agreed that having a China strategy now is essential, even though activity is likely to ramp up over a period of time given the structural challenges that will need to be addressed.

Regulatory and funding requirements are also driving structural changes for broker dealers

Innovative uses for tri-party, in particular pledge structures for collateral, were an active topic of discussion. Originally intended to manage haircuts or margin, pledge structures could be used for the entire loan exposure amount following the successful use of pledge models in tri-party for segregated initial margin. Pledge structure, which leverage the existing market infrastructure, could be quicker to market than other emerging options, such as central counterparty structures.

Broker dealers believe that pledge structures offer the potential for a reduction in the cost of capital, while lenders also see possible benefits that could include increases in spread, haircut and simplified reporting. However, one challenge for lenders will be explaining the impact of moving to a pledge structure and obtaining the consent of underlying beneficial owners. A standardized principal relationship agreement (GMSLA) and security agreement supporting pledge structures is expected soon from the International Securities Lending Association (ISLA).

The ability to support potential changes in booking models

Previously mentioned regulatory and funding requirements are also driving structural changes for broker dealers. Most have seen better integration across desks over the last few years, as financing is viewed more holistically than in the past. And, while many decisions related to capital allocation, financing or trading are still made centrally from New York or London, some of the firms represented at the roundtables are evaluating their booking models. Roundtable participants discussed a 'hub and spokes' model that could create greater regional autonomy, and noted that local support for increased collateral or financing activities would become ever more important. However, a 'one size fits all' model is unlikely, particularly given impending geopolitical changes such as Brexit.

In conclusion, participants seemed optimistic about 2018 although some broker dealers noted that the recent growth seen in collateral balances does not necessarily equate with balance sheet growth. In some cases, regional desks are benefitting from additional allocation of relatively flat balance sheets globally, due to higher yielding markets in Asia Pacific. Lenders feel that balance growth has been underpinned by market strength, but expect to see more borrows to hedge long positions in case of market turbulence.

We expect these themes to be important for some time to come, as the ongoing introduction of regulation in different markets is likely to have a continuing impact on how each firm manages their capital, financing and liquidity decisions. Given that, the need for control – with access to a variety of button and levers that can be pushed to create bespoke solutions – remains paramount.

J.P. Morgan's collateral roundtables took place between January 29 and February 5, 2018.

China capital markets

Be prepared to seize the investment opportunities

China is widely regarded as one of the most attractive markets globally for investors. Yet, many corporate and institutional businesses may be unsure of where the opportunities lie or how to take advantage of them.

The good news is that in recent years, China has been reforming its capital markets, liberalising its financial system and internationalising its currency to encourage more foreign corporates and institutional investors to participate in its economy.

We are the perfect partner to help you take advantage of the opportunities in China's capital markets. Recognised for our strength, experience and unrivalled network, we are here to support you.

Increasing connectivity over time

China is gradually opening up its capital markets, with simplified channels, enlarged quotas and easier access for foreign financial institutions and investors.

2002

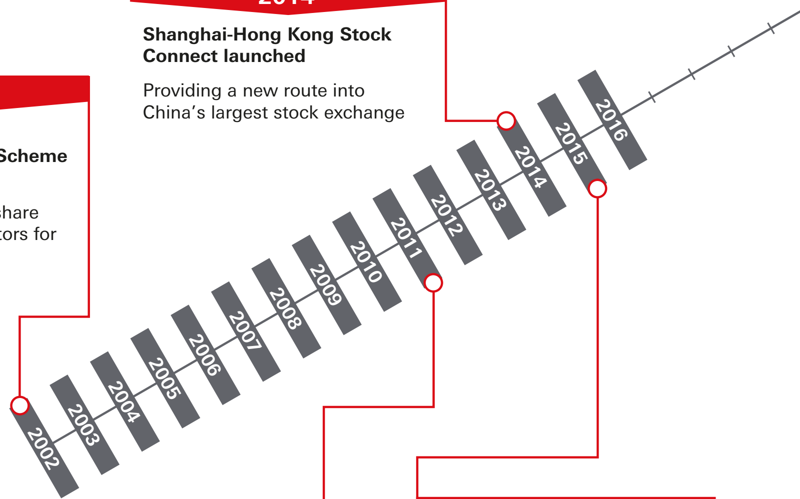
Qualified Foreign Institutional Investor Scheme (QFII) launched

Opening up China's A-share market to foreign investors for the first time

2014

Shanghai-Hong Kong Stock Connect launched

Providing a new route into China's largest stock exchange



2011

RMB Qualified Foreign Institutional Investor Scheme (RQFII) launched

RMB version of QFII officially launched, allowing onshore securities to be traded

2015

Mutual Recognition of Funds (MRF) launched

Providing mainland China and Hong Kong products with new cross-border mobility

2016

China Interbank Bond Market (CIBM) Direct launched

Giving foreign financial institutions access to a wide range of fixed income instruments in China's bond market

October 2016

Inclusion of RMB into the International Monetary Fund's Special Drawing Right currency basket

RMB now makes up 10.92% of the basket

December 2016

Shenzhen-Hong Kong Stock Connect launched

Providing access to a market that is home to many "new economy stocks" in sectors like technology, media and healthcare

2017

June 2017

Inclusion of A-shares into MSCI's Emerging Markets Index is announced

To be implemented in 2018, driving greater demand by foreign investors for onshore exposure

July 2017

Bond Connect launched

Allowing overseas investors to trade on the CIBM with their usual international methods via the Connect platform and settle bonds more simply via Hong Kong

2018

Investing in China's capital markets

With the further opening up of the onshore capital market, offshore investors can now access China's equity and bond markets via a variety of schemes. The schemes are designed for different types of investors and products.

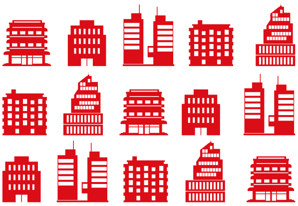
		Applicable products
Inbound Investment	QFII Scheme	• Exchange-listed A-shares, bonds and warrants • Fixed income products traded in interbank bond market • Securities investment funds • Index futures (for hedging only) • Subscription to initial public offerings, additional issuance, rights issues and convertible bond issuance
	RQFII Scheme	• Exchange-listed A-shares, bonds and warrants • Fixed income products traded in interbank bond market • Securities investment funds • Index futures (for hedging only) • Subscription to initial public offerings, additional issuance, rights issues and convertible bond issuance
	CIBM Scheme	• Cash bonds in interbank market, including government bonds, People's Bank of China (PBoC) bills, financial bonds, commercial paper, medium-term notes, bond forwards, bond lending and other instruments • Derivatives such as bond forwards, bond lending, interest rate swaps and forward rate agreements • Type 2 and 4 investors are only allowed to invest in derivatives for hedging purposes; type 3 investors are only allowed to invest in cash bond and certificates of deposit; no restriction for type 1 investors
	Bond Connect	• Fixed Income instruments in interbank market, including government bonds, PBoC bills, financial bonds, commercial paper, medium-term notes and other instruments (The initial phase of Bond Connect only supports Northbound Trading by institutional professional investors)
Two-way Investment	China Stock Connect	**Northbound** • Constituent stocks of SSE180 index and SSE 380 index • Constituent stocks of SZSE Component Index and SZSE Small/Mid Cap Innovation Index with market capitalisation not less than RMB 6 billion **Southbound** • H-shares in LargeCap index and Mid-Cap index • H-shares in SmallCap index with market capitalisation not less than HKD 5 billion • Dual-listed A and H shares on SSE or SZSE and SEHK
	Mutual Fund Recognition (MRF)	• General equity funds • Bond funds • Mixed funds • Unlisted index funds • Physical index-tracking exchange traded funds

Eligible investors	Dealt currency*	Asset allocation
• Overseas asset management companies, insurance companies, securities firms, banks, funds, government agencies	Onshore CNY	No restriction on asset allocation
• Qualified financial institutions in designated offshore RMB markets	Onshore CNY	No restriction on asset allocation
• Type 1: Central banks, monetary authorities, international financial organizations, sovereign wealth funds • Type 2: RMB clearing banks, overseas RMB participating banks • Type 3: QFIIs and RQFIIs • Type 4: Other foreign institutions	Onshore CNY and foreign currency	No restriction on asset allocation
• Central banks, monetary authorities, international financial organizations, sovereign wealth funds • Commercial banks, insurance companies, securities firms, asset management companies, other wealth management and other financial institutions	CNH or CNY (dealt offshore)	No restriction on asset allocation
Northbound • All Hong Kong and overseas institutional and individual investors **Southbound** • Qualified mainland investors (Remarks: ChiNext participation is limited to institutional professional investors)	CNH	N/A
• General investors for publicly offered funds in mainland China and offshore markets	N/A	Funds sold in Hong Kong cannot be invested mainly in Hong Kong, and vice versa

*CNY refers to onshore RMB and CNH refers to offshore RMB.

We know the way

With our unrivalled heritage in China together with our global presence, leading service and financial expertise, we can show you and your business the way.



Global network

with over

3,900 offices

across 67 countries and territories.

Leading international bank in China

We are the leading international bank with the largest onshore network in China and 24 China desks around the world.

Leading international bank for RMB

We have established RMB trade settlement capabilities across more than 50 markets globally and dedicated RMB experts in key offshore centres.

HSBC Qianhai:

We have partnered with Qianhai Financial Holdings to offer HSBC Qianhai. HSBC Qianhai is your simple, convenient doorway into China's capital markets. HSBC is the first foreign bank to have a majority-owned securities joint venture in China.

At HSBC Qianhai, we work closely with HSBC's bankers and product specialists to bring you a broad spectrum of investment banking and market products and solutions

Timing

Phase 1 – we have obtained the following licenses in November 2017 to offer:

- Underwriting and sponsoring
- Brokerage
- A-share research

Phase 2 – by the end of 2018 we are applying for licence to offer:

- Mergers and acquisitions advisory
- Trading
- Asset management

1. Sharing your strategic vision

We start by understanding your business

We recognise that the world's capital markets are complex and highly interconnected, and that clients with strategic China interests look to us for advice and well-established execution services. Only by investing the time to understand your business's background, strategy, people, infrastructure, policies and procedures we can provide you with the bespoke services you need to achieve your goals.

2. Extensive capabilities in underwriting and sponsoring

Need securities underwriting and sponsoring advice?

HSBC Qianhai offers a wide range of securities underwriting and sponsoring expertise:

- Primary equity and debt capital markets
- Secondary equity offerings
- Bespoke structured financing
- Corporate advisory services:
  - » Business valuation
  - » Negotiation
  - » Pricing and structuring of transactions

Looking to access China's debt capital markets?

If you're looking to raise funds from fixed income instruments, we can help you access China's huge onshore debt capital markets, one of the largest bond markets in the world. We offer:

- Well-established international bank with on-the-ground debt capital markets teams
- Holistic financing solutions encompassing both the exchange and interbank markets jointly with other HSBC entities
- Facilitation of two-way cross-border financing
- Support for domestic issuers to access the international debt markets

Your competitive advantage

- Competitive debt financing solutions including:
  - » Enterprise bonds, corporate bonds, medium-term notes and commercial paper
  - » Financial bonds
  - » Asset backed securities
  - » Panda bonds
  - » Hybrid and sustainable bonds

Require equity capital markets expertise?
Our capabilities in onshore equity issuance complement HSBC's leading international banking platform. This vital piece of our capital financing services covers a broad range of products including:

- Initial public offerings
- Follow-on offerings
- Rights, convertible bonds, exchangeable bonds, and preferred shares issues

3. Experience and advice in Mergers and Acquisitions (M&A)

A full range of M&A advisory services
(upon obtaining license)*
We aim to offer M&A advisory services to state-owned and privately owned Chinese corporates, multinationals, financial sponsors and sovereign wealth funds.
Our experienced teams will be able to help you achieve further growth and expansion through both domestic, outbound and inbound activities including:

- Overseas investments
- M&A transactions
- Corporate restructurings

We will also work closely with HSBC's global M&A bankers, sector specialists and financing solutions teams to execute complex cross-border transactions.

Experienced M&A teams with a breadth of knowledge

- Our global M&A business is handled by specialist M&A bankers in nearly 30 countries around the world, including some of today's fastest growing emerging markets
- Product specialists delivering on-the-ground, in-depth insights
- Bankers based in the relevant country or region
- Specialists with relevant industry expertise
-

A one-stop M&A solution
Bringing together our global network and our M&A business provides a one-stop solution which will aim to help Chinese corporates, institutions and multinationals achieve their M&A ambitions including:

- Relevant, up-to-date market intelligence
- Access to HSBC's full suite of global and domestic financing and risk management products

4. Keeping you informed with Global Research

High quality, award-winning research and analysis
Our analysts are ready to equip you with topical, relevant and actionable ideas and commentary. We aim to cover over 400 pure A-share companies by the end of 2020, with a focus on the higher growth new economy sectors. The research reports will be published in English and Chinese simultaneously and distributed globally, as the first of their kind. Insights include:

- Major investment themes
- Breaking news
- Global views and local ideas
- Insight on specific opportunities
- Strong connections to HSBC's research network and offshore research capabilities
- Global research on the macro-economy, foreign exchange, stocks and fixed income in existing and emerging markets

5. Helping you access China's markets

Providing a range of China securities brokerage services
By leveraging HSBC's long-established connectivity to issuers, markets and investors, HSBC Qianhai gives you world-class brokerage services, and access to China's exchange traded equity and fixed income markets.
Our broad execution capabilities and strong network can help you enhance your market liquidity and efficiency.
Our range of services includes:

- Connection to HSBC teams around the world in 80 countries and cash bonds across 50 countries
- Sales coverage on cash equities and bonds
- Real-time connectivity to the Shanghai and Shenzhen Stock Exchanges
- Trade reporting
- Research publication
- Corporate access services

*We are applying for a license to offer M&A advisory and other services by the end of 2018.

A strong partner in China

With our global network and in-depth local knowledge, we are uniquely qualified to fulfil the needs of corporate and institutional businesses looking to seize the huge opportunities within China's capital markets.

Leading foreign bank in providing China connectivity

HSBC China has the most banking and investment related licenses among foreign banks.

Best offshore RMB services provider across Asia Pacific

HSBC has been the winner of "Best Overall Provider of Offshore RMB Products and Services" in the Asiamoney Offshore RMB Poll for six consecutive years, and voted as the best in the following categories in 2017:

- Liquidity management
- Clearance, transaction banking and settlement
- Bond origination
- Research
- Foreign exchange
- Advice/information on offshore RMB regulations
- Fund services
- Derivatives
- Fund investment
- Wealth management

Extensive China research capabilities

We have comprehensive research coverage of the China market across all asset classes on topics including:

- Economics
- Credit
- Currencies
- Equities
- Fixed Income
- Rates
- Climate change

Strong presence in the Pearl River Delta

Our market leadership in Hong Kong has provided a strong basis on which to build a sizeable presence in the Pearl River Delta area, particularly in the growth areas of:

- Foreign exchange
- Derivatives
- Metals
- Cross-border businesses

Highly active in corporate access

- Over 120 group and bespoke investor trips to China in 2017
- Flagship annual China conference in Shenzhen with 150 corporates
- China Discovery Forum with 20 corporates
- Dedicated corporate access team in Shenzhen

Leading bank in QFII and RQFII custody

#1

HSBC is the leading onshore custodian bank in the QFII and RQFII schemes, with 33% and 54% of market share in terms of quota under custody respectively (as of Sep 2017). [1]

Significant market share in Stock Connect

Our combined trading and custody strategy has seen us capture significant Stock Connect market share where we hold between 40-45% of the Shanghai Connect shares. [2]

Leading bank in Bond Connect

HSBC China is one of the Bond Connect onshore dealers appointed by the PBoC to provide quotes and trade directly with foreign investors.

HSBC Hong Kong is one of the settlement banks in Hong Kong permitted to provide foreign exchange conversion from foreign currencies to RMB at onshore CNY rates and related hedging services, and also offers custodian services.

Strong in China Interbank Bond Market (CIBM)

- First foreign bank approved as joint lead underwriter for Panda bond issuances by offshore non-financial corporates in CIBM. This is on top of the current capabilities to act as joint lead underwriter for Panda bond issuance by foreign financial institutions and sovereigns.
- Bond settlement agents to assist foreign investors to access the onshore interbank bond market.
- Leading wallet share in offshore central banks trading among foreign banks.

Multi-award winning in Asia

- Asiamoney Country Awards 2017 – Best International Bank in China
- Euromoney Awards for Excellence 2017 – Asia's Best Bank
- FinanceAsia Country Awards 2017 – Best Foreign Bank in China

[3]

1 Internal HSBC analysis based on information from the State Administration of Foreign Exchange
2 Internal HSBC analysis based on information from the Hong Kong Stock Exchange
3 www.gbm.hsbc.com/about-us/awards/2017

Country profiles

Comprehensive guide to securities finance

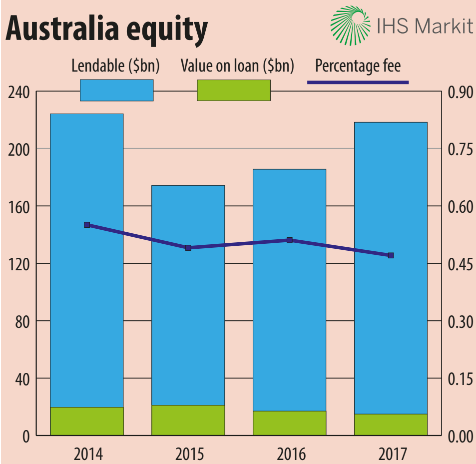
Australia

Australia was one of the top performing securities finance markets in the Asia-Pacific region, increasing its lendable assets to $224 billion by the end of the year. This total cemented Australia's position as the third largest Asia-Pacific lending market, behind Japan and Hong Kong.

The 2017 total was up almost 30% on the total of lendable assets in the previous year and restored the Aussie market to the same level as 2014 when the value of assets available for lending was just short of $220bn.

The value on loan in 2017 decreased however from the previous year, falling to $19.6bn from $21bn in 2016. Yet this was still way above 2015 levels when less than $17bn was out on loan. The percentage fee was relatively stable on previous years, edging up to 0.55% from 0.49% in 2016, 0.51% in 2015 and 0.47% in 2014.

Australia equity



- Australia is the fifth largest market in Asia Pacific by revenue
- Equity lending revenue grew by 13% to $92m
- The increase in fees, up 8bps to 58bps, was partly offset by decreasing utilization
- Specials demand driven by the Materials & Retailing
- Lendable inventories grew by 30% to $255bn

Australia is a mature lending market and is held up by lending experts as a template for other countries in the region to copy.

The supply side of the market is strong with lending inventories benefiting from inflows to superannuation funds while there is consistent demand from beneficial owners in the country. Some of the world's top passive funds, which have been swelled in recent years by the vast inflows to these vehicles, said in late 2017 that they do not lend Australian securities however.

Historically, demand has lagged supply as Basel III and other draconian capital requirements on financial institutions including banks have been implemented in Australia.

Australia has a strong onshore market but offshore participants are not eligible for the franking credit (a tax credit), which is extended to onshore lenders, so the Aussie market has seen instances of differential pricing.

The country also has a history of intervention in the short-selling market and banned both naked and covered short sales as recently as 2008 thought this decision was reversed in mid-2009.

Since June 2010 the Australian Securities and Investments Commission (ASIC), the main Australian regulator, has required all stockbrokers to report their total short sale positions daily.

Australia has its own securities lending trade association, formed in August 1991 in response to a perceived need amongst industry participants for unified representation in regulatory and other issues relevant to its members.

The Australian Securities Lending Association sees its role as assisting regulatory development and promoting standardisation throughout the industry in terms of documentation and market practice.

ASLA membership is open to all industry & non-industry participants and currently boasts 33 members represent investment banks, custodian and commercial banks, brokers, legal firms and technology providers.

The Australian repo market has also grown in recent years. The value of borrowing and lending cash broker through $100bn in 2016 and was attributed to a report at the time to local regulatory changes rather than global capital regulation.

A report into the Australian repo market by Chris Becker, Ashley Fang and Jin Cong Wang, concluded: "The increase in repo rates in recent years can largely be attributed to different causes in different jurisdictions. The introduction of prudential regulations that require dealers to hold more capital against their market-making activities may have been a factor where the leverage ratio is a binding constraint (CGFS 2015). "

The report added: "In Australia, this is less likely to be the main factor, given that the repo market is a relatively small share of the financial system. Instead, market developments related to the foreign exchange swap market and the bond futures market appear to be contributing to the recent increase in repo market activity by non-residents."

In 2013, the Australian Securities Exchange (ASX) partnered with its Brazilian, Spanish, Luxembourg and South African counterparts, to develop a new service called the Liquidity Alliance, to provide common and sustainable collateral management solutions for the global financial industry.

The Liquidity Alliance members share a white-labelled collateral management technology that they claim is unique in the industry as it enables domestic assets to remain in custody within the domestic infrastructure and the domestic jurisdiction – a fundamental requirement in many markets.

China

Chinese equities market had a memorable year but the Chinese equity lending market has a long way to go to rival the largest markets in the Asia Pacific.

A report in early 2017 by trade body the Asia Securities Industry and Financial Market Association (Asifma) was concise in its assessment.

Asifma wrote: "While not prohibited in China, short selling is cumbersome and all but impracticable because the stock borrowing and lending (SBL) market is inefficient and expensive."

The report continued: "Short selling in China will only become feasible when there is a reasonably efficient market for SBL and margin financing. Industry, exchanges and regulators should collaborate to develop rules and mechanisms to bring about such an outcome."

The report, which looked at various aspects of the Chinese financial markets industry, went further by estimating the size of the onshore Chinese lending market. The Asifma report reckons the onshore Chinese lending market peaked at about RMB 9bn (£1bn) in mid-2016 when the equivalent of about 0.025% of the Chinese A-shares market cap was being short-sold.

This number since fell back to about RMB 3bn or about 0.01% of the A-shares universe in late 2016, according to Asifma.

Roy Zimmerhansl, the global head of securities lending at HSBC, has said China is anomalous because, like India, its lending market is minute compared with its equities based and the lending market is virtually inaccessible to non-Chinese institutions.

Jansen Chua, State Street's Asian head of securities finance, however has identified both China and India as "the key growth markets in the Asia Pacific".

The biggest recent step towards the gradual opening up of the vast Chinese onshore equities market to international participants came in mid-2017 when China's A-shares were finally approved for inclusion in the calculation of MSCI's key international benchmarks.

Speaking at the time, the Pan Asia Securities Lending Association (Pasla) said: "Whilst not directly opening up the securities financing markets onshore, or through the Connect, this is an important step in continuing to reform and open up the broader China market to international investors."

The trade body continued: "Although the initial impact will be small, on a relative basis, we think it's a hugely symbolic step and shows how much work has been done by the China Securities Regulatory Commission (CSRC) and the People's Bank of China (PBOC) in order to integrate China's markets into MSCI."

It concluded: "Pasla looks forward to further reform in developing the securities financing rules and access capabilities for both onshore and offshore participants."

The Chinese equities market undoubtedly had a solid year. A research note on Chinese equities in 2018 by UBS Asset Management head of China equities Bin Shi opened: "2017 was a strong year for Chinese equities with the economy performing better than expected and many stocks rising from low valuations."

In the report, UBS argues the Chinese health, technology and consumer sectors have their own fundamental drivers which are unaffected by changes in China's macro-economic status.

Shi continued: "Improving corporate governance in China will also promote investors' understanding of Chinese companies. We believe that the quality of companies currently in the Chinese equity markets is much higher than before, and that raises the prospect of sustained performance in the markets over the longer term."

The Chinese repo market is more established but similarly tricky for non-Chinese firms.

A report by Richard Comotto, senior visiting fellow at ICMA Centre, University of Reading, said the Chinese market is segmented into the over-the-counter inter-bank market (IM) and the exchange-traded market, which is divided between the Shanghai and Shenzhen Stock Exchanges.

The IM for example was created in 1997 exclusively for Chinese commercial banks but has seen its participation gradually increase to include exchange members. The entire exchange-traded market and the IM (around 97%) are pledged repo while the IM also trades "outright repos".

The report added that there is no right of re-use of collateral and virtually all the collateral in the market is illiquid, meaning the market is almost completely cash-driven.

The report concluded that the IM is the main repo market segment in China because it is home to the major liquidity providers, which are the policy banks.

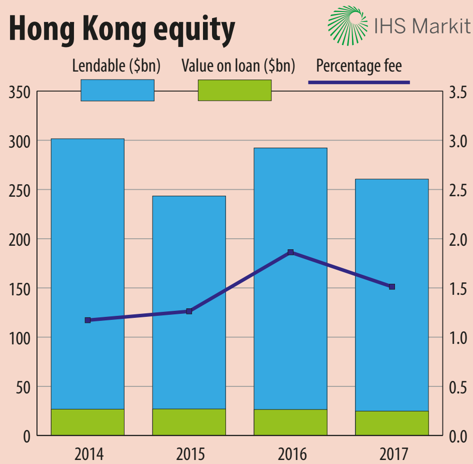
Hong Kong

Hong Kong is the second largest lending market in the Asia pacific region by lendable assets. It has a lendable portfolio of $301bn, which puts it second only to Japan with a vast $678bn. Hong Kong's lendable market grew by almost a quarter in 2017, from $243bn in 2016 and surpassed the levels last seen in 2015 when $292bn was available for lending.

IHS Markit analyst Sam Pierson said: "Hong Kong was the only country in the region to be essentially flat from a revenue perspective, with a decline of 1.3%, while all other countries moved up or down by at least 10%. The flat revenue does belie some changes under the surface, as a 9% increase in balances was offset by a 9% decrease in fees."

Hong Kong's 2017 value on loan was consistent with previous years, at $26.7bn versus $26.9bn in 2016 and $26.35bn in 2015. Hong Kong's percentage fee of 1.17% is higher than those in Japan (1.01%) or Australia (0.55%) but is lower than recent years. The Hong Kong fee was 1.26% in 2016, 1.86% in 2015 and 1.51% in 2014, according to IHS Markit data.

Hong Kong equity



- Hong Kong is the second largest equity market in Asia Pacific, contributing 22% of revenue in the region
- 2017 equity lending revenue down 1% from 2016, at $248m
- Decreasing fees offset an increase in borrow demand
- Specials demand driven by Real Estate, particularly Fullshare Holdings & China Sunac Holdings
- Revenue from specials contributed 83% of total equity revenue
- Lendable inventories grew by 30% to $310m

IHS Markit said in a January 2018 report reviewing securities lending performance in late 2017 that Hong Kong was home to four of the top 10 revenue generating stocks in 2017.

Pierson said: "China Fullshare Holdings was the highest revenue grossing stock in Hong Kong for 2017, delivering over $22m in revenues. The increased demand, and fees, came after a well know short seller criticised the firm in April."

He added: "The second highest revenue grossing stock was BYD Co Ltd, which pitted short sellers against legendary investor Warren Buffett. It remains to be seen whether the shorts will be proven correct about the firm's valuation, however share owners received $17m in lending revenue for the stock in 2017."

An IHS Markit paper by Pierre Khemdoudi and Ed Marhefka, the firm's managing directors and global co-heads of securities finance and Delta One products, said in January: "Hong Kong continued to shine in the fourth quarter, with revenues increasing by more than 30% compared with the fourth quarter 2016. After a relatively flat revenue trend during the first three quarters, the fourth quarter surge was primarily driven by increasing loan balances, but fees posted modest gains as well."

The report continued: "Increased specials revenue was driven by a surge in fees for Semiconductor Manufacturing International Corporation, as well as a spike in fees and balances for Kingston Financial Group Ltd."

Hong Kong remains a unique Asian opportunity as the international gateway to China's vast equities pool.

Bin Shi, the head of Chinese equities at UBS Asset Management, said: "As China's equity opportunity set changes, China's equity markets are becoming more accessible than ever. The launch of the Shenzhen-Hong Kong Stock Connect in late 2016, following the Shanghai-Hong Kong Stock Connect in 2014, has opened up a wide range of opportunities for overseas investors."

The UBS research note added: "Overseas investors are allocating more capital to China's equity markets, with aggregate figures showing foreign investors' total holdings reached RMB 1.02 trillion at the end of September 2017, a 50% increase from the RMB 656 billion recored at the same point in 2016, according to data compiled by the People's Bank of China."

Shi added: "Overseas investors will likely become more active in the market when 222 A-share stocks enter the MSCI benchmarks in June 2018. The 222 names to be included are all blue-chip companies and may get a boost in 2018 as overseas investors step-up their capital allocations."

Valerie Rossi, global head of securities finance at ABN Amro Clearing Bank, said: "HSI and HSCEI indices performed admirably in 2017 along with most global markets. As the rally maintained momentum through the year we saw a corresponding increase in trading activity. Transparency and risk control remained high on the regulatory agenda."

Rossi added: "2017 saw the expansion of the short position reporting regime to cover a much broader range of stocks. In 2018 and the Chinese Year of the Dog, we anticipate further expansion of the product range under the various Stock Connect platforms with increased risk controls such as the implementation of investor identification for trading under the Stock Connect programme."

India

India's securities lending market is relatively unique in that The National Stock Exchange (NSE) and Bombay Stock Exchange ('BSE') clearing corporations act as CCPs to all lenders and borrowers, according to Eusebio Sanchez, regional head of agency securities lending, APAC, at Citi.

"SBL contracts trade on screen like futures with fixed expiries, prices are quoted outright in Indian Rupee," he explains. "Borrow fees are paid up front and lenders collateralize loans between trade and settlement date but do not receive collateral themselves – it remains with the CCP."

For investors, Sanchez said this presents specific operational, credit and legal challenges. "We have been servicing domestic clients for several years, but in consultation with our international client base we have found it necessary to implement system enhancements to accommodate India's market nuances, ensuring we are able to provide global beneficial owners with the same reporting, controls and transparency standards as they enjoy in other international markets."

Nisha Pillai, senior manager at India's National Securities Clearing Corporation (NSCC), points out that regulators and the NSCC have provided various guidelines on participation in SBL. "These include position limits applicable for each securities and participants, requirement of margins for borrow and lend position, restricted on participation on borrowing side for certain entities, FPIs can borrow only to cover short sell in capital market."

A circular from the Securities and Exchange Board of India (SEBI), dated November 2017, relaxed certain norms related to SBL. "According to us this will help in further development of SLBS market," Pillai adds. "Foreign participants are showing lot of interest to participate in SBL activities in India. We have seen many queries coming from Indian custody in this regard. Market awareness needs to improve for increased foreign participation."

Citi's Sanchez said it helps that India's exchanges and regulators are taking steps to encourage participation. "They have extended maximum lending periods, introduced the ability for multiple rollovers and materially increased position limits, aligning individual limits for clearing members and institutional investors and keeping only the 10% of the market wide position limit," he adds. "They have also responded to participants concerns about automatic close-outs for all corporate actions, allowing non-voting participant loans to remain open over AGM."

Annually, the reported lending turnover has been around \$1 billion, accruing total fees of around \$10 million according to the NSE. These numbers were roughly flat in 2017 vs 2016, but currently represent a fraction of the lending fees accrued across APAC Markets, which is estimated to be upwards of $1.5 billion during 2017. Sanchez said one of the main reasons there hasn't been more growth is a lack of foreign participation at either end of the SBL chain (beneficial owners – short sellers).

"This starkly contrasts to most other markets in the region where international investors account for around three-quarters of securities lending and borrowing activity and 90% of short selling activity," the executive explains. "The incumbent lenders in India are domestic mutual funds, insurance companies or the Indian branches of international investors and borrowers are almost exclusively domestic brokers' short selling as an arbitrage against futures."

The house view at Citi is that few things would bring more international investors to the Indian market. Sanchez adds: "In Taiwan, Korea and Malaysia, adding a bilateral lending option to the existing CCP models dramatically increased participation by foreign and domestic lenders and borrowers. India may see a similar increase if a bilateral option were to be offered to institutional investors, which can co-exist with the current CCP model and ensure adherence to the level of transparency the regulator desires."

Additionally, he reckons borrowing would pick up if foreign firms had more collateral flexibility under the CCP model, including the provision of non-cash collateral rather than Indian Rupee cash. Finally, segregating lender's collateral at the clearing house for CCP trades might give lenders more comfort around legal certainty as well as improving ROA metrics.

"In the meantime, we're confident that we can deliver on clients' return expectations by lending through the CCP under the existing rules," said Sanchez. "Our foreign investor participation solution is very scalable and if our experience in other new markets is any guide, the emergence of lending supply can lead to a material increase in borrowing interest and demand.

"Finally, as in many other jurisdictions, Citi has played a major role in promoting market advocacy and remains committed to engagement with the exchanges and regulatory authorities in India in supporting the ongoing oversight and assessment of the SBL framework."

Recent enhancements by SEBI to India's securities lending mechanism

FEATURES	EARLIER GUIDELINE	REVISED GUIDELINE W.E.F. JANUARY 01, 2018
Tenure of the Contract	Monthly contracts. Maximum 12 Monthly contracts	Clearing corporation can decide different tenure contract ranging from 1 day to 12 Months based upon the need of market participants.
Position limit of Institutions / TM / CM	10% of Market Wide Position Limit (MWPL) or Rs.50 Cr whichever is lower	Removal of absolute limit. Revised limit - 10% of the MWPL
Roll over	Roll over shall be available for a period of 3 months i.e. the original contract plus 2 rollover contracts	Rollover is permitted up to 12 months from the date of original contract. Multiple times rollover of an existing position is permitted
Corporate Action	Mandatory foreclosing the contracts for AGM/EGM. Foreclosure for certain corporate actions 2 days prior to ex-date	Separate contract be made available which shall not be foreclosed in the event of AGM/EGM. Foreclosure for other corporate actions on ex-date instead of 2 days prior

Japan

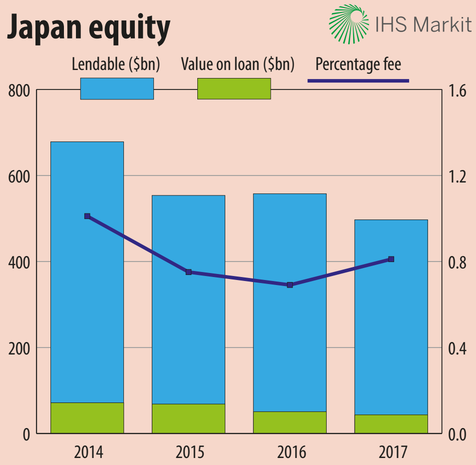
Japan has the largest lendable balance of the countries in the Asia Pacific region, with $678.45bn, which is more than double the lendable inventory in the next largest market, which is Hong Kong with $301bn.

Japan's lendable balance in 2017 was up 23% from the previous year's $553.71bn and compared favourably with $557.65bn in 2015 and $497.1bn in 2014.

The Japanese value on loan was $71.4bn in 2017, up slightly on 2016's $68.4bn and significantly on 2015's $50.68bn and 2014's $43.22bn.

The Japanese percentage fee rose a quarter in 2017, to 1% from 0.75% in 2016, 0.69% in 2015 and 0.81% in 2014 but is still among the lowest in the region.

IHS Markit said: "The major driver of increased regional revenues in 2017 was Japan, where equity lending revenue posted a $146m revenue increase, wrapping up 2017 with a massive $457m in revenue. That strong result is even better than the $100m revenue increase 2016. While Japan was already the most revenue generating market in Asia, the lead has been extended with Japan now contributing 40% of regional revenues, up from 33% in 2016."



- Japan is the largest equity lending market in Asia Pacific by revenue
- The Japanese market led the increase in regional revenue, the $457m in revenue generated was 47% of the regional total
- Average fees increase by 34bps while loan balances increased 13%
- Specials demand driven by Software industry, most notably Metaps & Jig-saw
- Percentage of revenue generated by specials up to 84% from 76% in 2016
- Lendable inventories grew by 26% to $712bn, leading to a 10% decline in utilization

IHS Markit said the increase in revenue for Japanese equities was driven by both increasing fees and loan balances. The proportion of Japanese shares which trade over 100 basis points has increased to 19% of all shares on loan, up from 15% in 2016.

The fee commanded by these specials also increased as borrowers were charged an average 570 basis points to borrow Japanese specials in 2017, up from the 497bps average in 2016, said IHS Markit.

Sharp Corp was the largest revenue contributor pulling in $45m during 2017. That's equal to 10% of total revenue for Japanese equities for the year. Cyberdyne Inc was in second place, with $24m, representing a 20% increase in revenue for the stock as compared with 2016.

Singapore

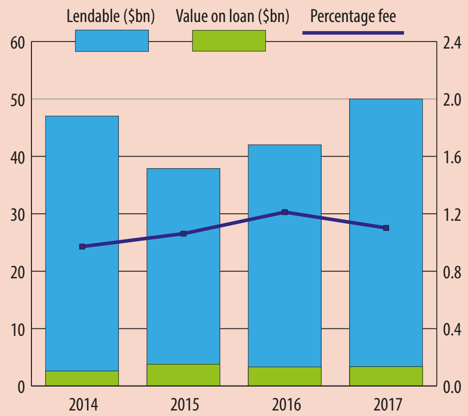
Securities lending revenues declined 37% in Singapore during 2017, according to IHS Markit, moving the country behind Malaysia as the sixth most revenue generating equity market in Asia.

"The declines in revenue in Singapore came entirely as the result of declining balances, as average fees were up," said IHS Markit analyst Samuel Pierson.

According to Jim Aris, head of equity trading for EMEA & APAC at Deutsche Bank Agency Securities Lending, loan values have dropped by a quarter during the first part of 2018.

"This might have thrown some lenders off the scent but weighted average spreads have seen an increase year to date with the average currently around 135 basis points," Aris suggests. "The key facet in the contraction of loan balances year-on-year, was the reduction in demand for stocks from within the industrial and financial sectors and equity markets ballooning in the latter part of the year."

Singapore equity



- Singapore is the seventh largest market in Asia Pacific by revenue
- Equity lending revenues declined by 37% in 2017
- Revenue decline driven by declining balances, fees were up by 5bps
- Specials demand led by Capital Goods, most notably Noble Group & Sembcorp Marine
- Lendable inventories grew by 24% to $48bn

Examples like Jardine Matheson, Keppel Corp and Noble Group reflect significantly reduced loan activity during the first two months of 2018. That said, Aris said Singapore often has the odd hidden treasure deep in client asset pools and should not be forgotten or over-looked.

"Revenue opportunities have emerged in sectors such as healthcare and materials which have both seen an increase in borrower demand," he explains. "Popular names have been Raffles Medical Group and more recently Midas Holdings, helping to drive daily revenue opportunities to double where it was year-on-year for the same period."

Singapore's central depository (CDP) offers more than 600 SGX-listed securities for loan under its securities borrowing and lending (SBL) programme. It acts as counterparty to both lenders and borrowers and assures the return of all loaned securities and collateral or their cash value equivalent. Since 2014, SGX has conducted periodic reviews and revision on the list of eligible securities and the respective margin rates for its SBL programme.

The SBL programme allows investors who hold their shares either in direct accounts with CDP or sub-accounts with a depository agent to sign up to lend their shares in return for a fee. Entities eligible to register to borrow securities from the CDP lending pool include clearing members, depository agents and banks licensed by The Monetary Authority of Singapore (MAS) - the central bank of Singapore.

South Korea

South Korean equity revenue failed to repeat the stellar performance of 2016, according to data from IHS Markit, with revenues declining a quarter year-on-year.

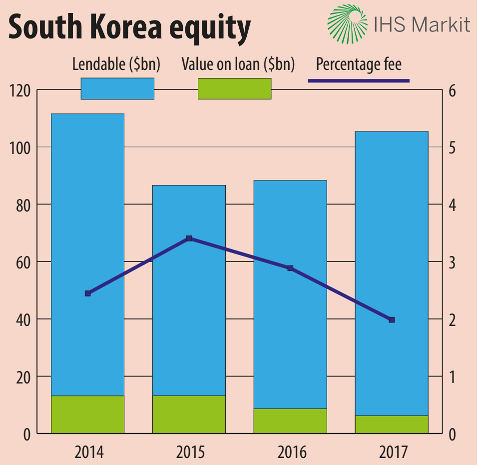
"That came entirely as the result of declining specials, as the loan balances actually increased slightly," explains IHS Samuel Pierson, analyst at the firm. "The revenue shortfall was a disappointment following an increase in revenues in 2016 which put South Korea nearly equal to Hong Kong as the second most revenue generating country in Asia."

Similar to last year's increase in revenue, Pierson says the 2017 decline is attributable to a single stock, biotech firm Celltrion.

He added: "Short sellers were not deterred by Celltrion's share price more than doubling in 2017, with borrow balances doubling during the year. The revenue decline was caused by consistently falling fees for the stock, a trend which began in mid-2016 and continued uninterrupted during 2017."

Lee Byung-rhae, chief executive of the Korea Securities Depository (KSD), backed the SBL business at the Pan Asian Securities Lending Association conference in Seoul last year.

South Korea equity



- South Korea is the third largest lending market in Asia Pacific by revenue
- Lending revenues disappointed, down 25% to $183m
- The revenue shortfall was the result of declining fees for Celltrion, which was still the most valuable equity with $25m in revenue
- Lendable inventories increased by 41% to $113bn

"Asian SLB markets, including the Korean market, are expected to grow consistently," he told conference delegates. "In the coming years, KSD will strengthen the network channel with domestic and foreign financial institutions as a leading institution in the Korean SLB market."

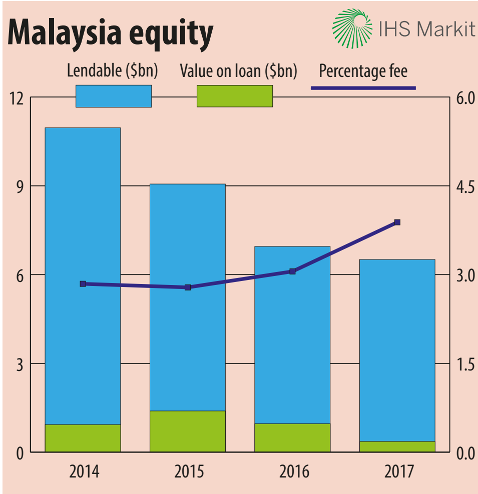
KSD also provides tri-party services to the institutional over-the-counter (OTC) repo market.

A report in 2017 by Richard Comotto, senior visiting fellow at ICMA Centre, University of Reading, said Korea's OTC market accounts for near all repo activity at some 80-90%. The exchange-traded market is operated by the Korea Exchange (KRX). KRX also acts as a central counterparty, guaranteeing the settlement of exchange-traded repo. Since 2006, KRX has also provided tri-party collateral management services.

"The repo market as a whole has benefited from the regulatory policy of pushing the money market out of unsecured call money into repo," Comotto wrote in his report, commissioned by Frontclear. "One incentive has been to exempt OTC customer repos from deposit insurance and reserve requirements, which means they pay higher returns than deposits and are therefore more attractive to investors. This has helped the OTC market to dominate repo trading."

On the other hand, he added that membership requirements imposed by the exchange could be a relevant factor in discouraging the use of the exchange.

Malaysia



The Securities Commission Malaysia (SC) and Bursa Malaysia launched negotiated SBL transactions in 2009. The model was a major step forward for the market as it offered firms an option to borrow and lend on an over-the-counter (OTC) basis.

Karu Ramesh Kumar, senior associate director, securities borrowing and lending (SBL) equity finance, Affin Hwang Investment Bank Berhad, has worked closely with the local regulators and Bursa Malaysia (the exchange) since then to promote and to encourage the greater use of SBL in the Malaysian market.

"Affin Hwang Investment Bank Berhad (AHIBB) offers institutional investors access to both lending and borrowing of shares for Regulated Short Selling activities," he explains. "We have been actively engaging and partnering local investment fraternity on SBL education and creating awareness on the benefits of SBL as an efficient portfolio management function and using borrowed shares as one form of risk management tool in trading activities."

In addition, Kumar reckons Malaysia has huge untapped Islamic funds where there is no alternative for Shariah compliant SBL product. "Recently, the exchange launched the Islamic Securities Sell and Buy Negotiated Transaction (iSSBNT), which is a Shariah alternative to conventional SBL. We foresee increased innovation in Shariah compliant investment products with the introduction of iSSBNT."

AHIBB hopes to offer iSSBNT to the Islamic fund managers and expand its supply inventory to cover conventional and Shariah stocks. One challenge, however, in respect of Malaysia SBL, would be that netting opinion on SBL transactions between local counterparties and foreign financial institutions remains a key area for negotiation in respect of the Global Master Securities Lending Agreement (GMSLA)

More broadly, Kumar sees large investments from and to China in areas relating to infrastructure, banking and securities sector which could ultimately trickle down and benefit the SBL market.

"There have been huge investments especially in the infrastructure of the high speed rail, forest, city and brokerage houses acquisitions by China investors. This will lead to more mergers & acquisitions, initial public offerings, placements exercises etc. and thus, create more demand and opportunities for the SBL market," he suggests.

AHIBB also has joint ventures with local partners in Thailand, Indonesia and Japan which, according to Kumar, provides promising potential for his firm to expand coverage to other markets.

Taiwan

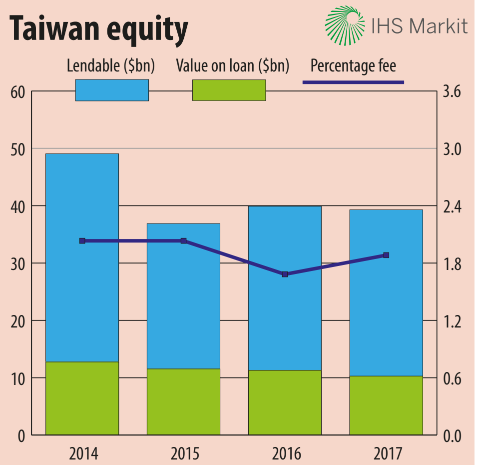
The Taiwan Stock Exchange Corporation's (TWSE) securities borrowing and lending (SBL) system and the SBL business conducted between securities finance firms are the two most critical securities lending channels in Taiwan.

It's been ten years since qualified securities finance companies were allowed to conduct SBL business acting as principals, giving investors additional options to borrow not only from the existing TWSE SBL system but also from their industry peers.

Two years ago registered firms were allowed to borrow securities from their clients, boosting volumes and enhancing market liquidity. Then, in July 2017, TWSE relaxed the qualification criteria limits to allow a wider spectrum of domestic corporations, funds, and offshore foreign institutional investors to be securities borrowers or lenders.

The exchange has also taken steps to widen the use of foreign currency collateral, adding five new currencies in recent years, including the Euro, Pound, Hong Kong dollar, Japanese Yen, and Australian dollar other than the original US dollar.

Taiwan equity



- Taiwan is the fourth largest equity lending market by revenue
- Lending revenues were up 15% in 2017, for a $103m
- Revenues were buoyed by a 24bps increase in fees and a 3% increase in balances
- Specials demand led by Technology sector, particularly AU Optronics & Macronix
- Lendable inventory grew by 34%, causing a decline in utilization

The daily SBL short selling ceiling has also been eased from a more restrictive 20% of the average trading volume during the previous 30 business days of the underlying stock to 30% of the average trading volume during the same period.

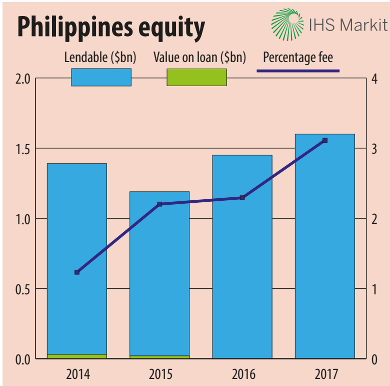
"Securities borrowing and lending not only increases income to the lenders and facilitates more efficient utilization of securities, but also leads to more stocks circulated in the secondary market," TWSE said in a statement last year. "Hence, liquidity in Taiwan's securities markets benefits greatly from the practice."

Lending revenues for Taiwanese equities came in at just over $100 million for 2017, up 15% as compared with 2016.

"While it is encouraging to see the revenue continue to pick up, it's worth noting that the revenues generated by the market are still below the greater than $130 million tally registered in both 2013 and 2014," says IHS Markit analyst Samuel Pierson.

The increasing revenue came both as the result of higher balances, up 3% year-on-year, and higher fees, up 24bps year-on-year. AU Optronics, the computer display manufacturer, was the most revenue generating stock according to IHS Markit, pulling in $4.1 million during 2017, despite borrow fees declining in the latter half of the year. That haul represents 4% of total revenue for Taiwan in 2017.

Indonesia and Philippines



Indonesia: Indonesia is small compared to the lending markets in neighbouring countries such as Malaysia or Singapore but it is showing positive signs.

IHS Markit analyst Sam Pierson said: "There was a great deal of dispersion in 2017 revenue results for the smaller Asian equity lending markets. Overall the comparison with 2016 was not positive, but there were some bright spots with Thailand, New Zealand and Indonesia all posting double digit revenue advances."

Indonesia's lendable inventory last year was $1.55bn, which was up a third on the previous year's $1.15bn and up on 2015's $1bn and 2014's $940 million. The value on loan was only $50m but this was up more than double on just two years ago.

The percentage fee in Indonesia was down slightly on 2016 to 0.85% from 0.95% the previous year. The percentage fee was over 2% as recently as 2014, according to IHS Markit data.

Indonesia is looking to expand its securities lending market and exploring the use of tri-party structures to unlock liquidity but synthetics are still popular.

Philippines: The Philippines is another market that is being watched closely in the region. The value of lendable assets was $1.39bn, which is 17% up on the previous year but down on 2015's $1.45bn or 2014's $1.6bn. The value on loan was $50m, which was up from $30m in 2016, and the percentage fee was down at 1.23% from 2.2% in 2016, 2.29% in 2015 and 3.11% in 2014.

IHS Markit analyst Sam Pierson said: "Singapore, Malaysia and the Philippines all posted double digit declines in revenue as compared with 2016."

The Philippines is making strides however in developing its lending market as well as its repo market which is almost ten years old. A report by Richard Comotto, senior visiting fellow at ICMA Centre, University of Reading, said the repo market faces various challenges including: "Insufficient participation to generate the critical mass needed to generate adequate liquidity, which could reflect the cost of membership and/or transaction costs; concerns about the risk stemming from pre-trade anonymity without the protection of a true central counterparties; and the legal framework underpinning repos traded on the exchange is cursory and is not supported by a legal opinion."

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