GLOBAL INVESTOR/ISF DECEMBER 2016/JANUARY 2017 NUMBER 285

GLOBAL INVESTOR ISF

DECEMBER 2016/
JANUARY 2017

Clear thinking

Strategies in the era of transparency, analysis of fees and harnessing data

FCA asset management investigation
SFTR reporting preparations
Jeff Conway on digitising State Street
Nordic beneficial owners analyse lending
ESMA asset segregation standards

IMN
Information Management Network

The 23rd Annual

BENEFICIAL OWNERS' INTERNATIONAL SECURITIES FINANCE & COLLATERAL MANAGEMENT CONFERENCE

January 31 - February 2, 2017

Fort Lauderdale, FL

Featuring Keynote Address From:

Manmohan Singh, *Senior Economist,* International Monetary Fund (IMF)
Ed Blount, *Executive Director,* Center for the Study of Financial Market Evolution

Women's Networking Lunch & Keynote Speaker:

Maria Fiorini Ramirez on 1/31!

A Partial Listing of Beneficial Owner Attendees Include:

CIO, **VOLVO PENSION TRUST**

Opportunistic Portfolio Manager, **CALPERS**

Chief Investment Officer, **OFFICER OF THE ARIZONA STATE TREASURER**

Treasury Manager, **MICROSOFT CORP.**

Director of Fixed Income Trading, **STATE BOARD OF ADMINISTRATION OF FLORIDA**

Portfolio Manager and VP, **DIMENSIONAL FUND ADVISORS**

Head of Securities Lending, **CHARLES SCHWAB & CO., INC**

Director, Investment Operations, **CANADA PENSION PLAN INVESTMENT BOARD**

Head of Securities Lending, **NORGES BANK INVESTMENT MANAGEMENT**

Investment Officer II, **CALPERS**

Managing Director, Head of TIAA Public Investments Risk, **TIAA GLOBAL ASSET MANAGEMENT**

Senior Manager Securities Lending, **CAISSE DE DEPOT ET PLACEMENT DU QUEBEC**

Portfolio Manager Fixed Income and Derivatives, **HOSPITALS OF ONTARIO PENSION PLAN**

Senior Investment Operations Analyst, **ARIZONA PSPRS TRUST**

VP, Treasurer's Office, **DEUTSCHE ASSET MANAGEMENT**

Vice President, **FIDELITY INVESTMENTS**

Fixed Income Analyst, **COLORADO PERA**

Securities Lending Analyst, Middle Office Client Service, **FRANKLIN TEMPLETON**

Jr. Trader, Global Trading, **FRANKLIN TEMPLETON INVESTMENTS**

Fixed Income Operations Analyst III, **STATE BOARD OF ADMINISTRATION OF FLORIDA**

Investment Analyst, **STATE OF WISCONSIN INVESTMENT BOARD**

Director, Asset Management Services, **TIAA–CREF**

Managing Director, Securities Lending, **PRUDENTIAL FIXED INCOME**

Accounting Control Manager, **STATE BOARD OF ADMINISTRATION OF FLORIDA**

Portfolio Manager, **ALLSTATE INSURANCE COMPANY**

Head of Special Equities Trading, **FIDELITY INVESTMENTS**

Assistant Portfolio Manager, **ARIZONA STATE RETIREMENT SYSTEM**

Associate Portfolio Manager, **CALSTRS**

Investment Risk Analyst, **T. ROWE PRICE**

Senior Analyst, Securities Lending, **TIAA–CREF**

Senior Analyst, **SVERIGES RIKSBANK**

Director, Global Custody Services Team, **FIDELITY INVESTMENTS**

Managing Director, Head of U.S. Cash Management, **STATE STREET GLOBAL ADVISORS**

Director of Finance, Accounting & Risk Management, **FLORIDA PREPAID COLLEGE BOARD**

Senior Legal Counsel, **FIDELITY INVESTMENTS**

Global Head of Institutional Cash Sales and Client Management, **DEUTSCHE ASSET MANAGEMENT**

Analyst, Equity Asset Strategies, **NORGES BANK INVESTMENT MANAGEMENT**

Sr. Portfolio Manager, **THRIVENT FINANCIAL FOR LUTHERANS**

Director, Treasurer's Office, **DEUTSCHE ASSET MANAGEMENT**

Senior Accountant II, **STATE BOARD OF ADMINISTRATION OF FLORIDA**

Collateral Trading, **BCS FINANCIAL GROUP**

President, CEO, **DESERET TRUST COMPANY**

Sr Manager, Legal Compliance, **ONTARIO TEACHERS' PENSION PLAN**

Sr Analyst, Portfolio Analytics and Investment Support, **PUBLIC SECTOR PENSION INVESTMENT BOARD**

Managing Director, Securities Lending, **CHARLES SCHWAB & CO. INC.**

Analyst Securities Lending, **CAISSE DE DEPOT ET PLACEMENT DU QUEBEC**

Managing Director, **CYS INVESTMENTS, INC.**

Managing Director – Fixed Income, **MASON STREET ADVISORS**

AVP, Treasurer's Office, **DEUTSCHE ASSET MANAGEMENT**

Manager of Finance & Accounting, **FLORIDA PREPAID COLLEGE BOARD**

Assistant Treasurer, **PINNACOL ASSURANCE**

Sr Vice President & Treasurer, **WESTERN & SOUTHERN FINANCIAL GROUP**

Use Discount Code 'ISF15' For 15% Savings!

For More Information, Please Contact: Gareth Tapper, (212) 224-3048, gareth.tapper@imn.org

CONTENTS

GLOBAL INVESTOR ISF

Editor Alastair O'Dell
Tel +44 (0)20 7779 8556
aodell@euromoneyplc.com

Associate editor Andrew Neil
Tel +1 212 224 3770
andrew.neil@euromoneyplc.com

Emerging markets editor James Gavin
Tel +44 (0)20 7779 8888
ppielichata@euromoneyplc.com

Reporter Merle Crichton
Tel +44 (0)20 7779 8004
merle.crichton@euromoneyplc.com

Contributors Paul Golden, Daniel Godfrey, David Rowley, Paul Dowding, Jonathan Adams, James Gavin, Alex MacDonald Vitale

Design and production Keith Baldock

Publisher Will Browne
Tel +44 (0)20 7779 8309
wbrowne@euromoneyplc.com

Mena and emerging markets director Zara Mahmud
Tel +44 (0)20 7779 8478
zara.mahmud@euromoneyplc.com

Head of business development Tim Willmott
Tel +44 (0)20 7779 7216
twillmott@euromoneyplc.com

Reprints Christine Jell
cjell@euromoneyplc.com

Divisional director Danny Williams

Global Investor/ISF
8 Bouverie Street, London, EC4Y 8AX, UK
globalinvestormagazine.com

Next publication
December/January 2016

Global Investor Incorporating ISF (USPS No 001-182) is a full service business website and e-news facility with supplementary printed magazines, published by Euromoney Institutional Investor PLC.

Annual subscription rate
US$1400 £875 (UK only) €965
ISSN 0951-3604

Chairman JC Botts

CEO Andrew Rashbass

Directors Sir Patrick Sergeant, The Viscount Rothermere, Colin Jones, Paul Zwillenberg, David Pritchard, Andrew Ballingal, Tristan Hillgarth

Printed by Buxton Press

Subscriptions
UK hotline (UK/ROW)
Tel: +44 (0)20 7779 8999
Fax: +44 (0)20 7246 5200
US hotline (Americas)
Tel: +1 212 224 3570
hotline@euromoneyplc.com

Renewals
Tel: +44 (0)20 7779 8938
Fax: +44 (0)20 7779 8344
renewals@euromoneyplc.com

Customer services
Tel: +44 (0)20 7779 8610
customerservices@ euromoneyplc.com

Latest must-reads from Global Investor/ISF online

ASSET MANAGEMENT

Hard-pressed European insurers invading territory of pension firms

Pensions business offers insurers recurring income for generally less onerous capital implications
bit.ly/2hph6pj

EU funds AuM hit new record in September

Net inflows in UCITS and AIF funds continued rapid recent trend
bit.ly/2gRo71b

Event driven hedge funds edge higher after Trump victory

Donald Trump's victory on November 8th was welcomed positively by markets
bit.ly/2gwu3QY

ESMA pressed to abandon strict sub-custody segregation

ESMA urged to abandon strict interpretation of the segregation of client assets
bit.ly/2gwwWS1

Fund managers react to government's green paper proposal

Additional measures proposed by UK government set to strengthen investors' hand on executive pay
bit.ly/2hlHWkK

ECB: Funds increasingly represent systemic risk

Liquidity mismatches in investment funds are an increasing threat to eurozone financial stability and require monitoring
bit.ly/2gsrWJ5

Asset manager M&A streak unlikely in near-term, says UBS

UBS skeptical of large asset management deals following Janus/Henderson merger
bit.ly/2hllas1

EU money market regs welcomed

EFAMA broadly satisfied with Money Market Fund Regulation but concerned about KYC and other aspects
bit.ly/2gRm6Cg

Hong Kong funds face tougher reporting rules

SFC says securities lending, repos and liquidity risk are areas in need of attention
bit.ly/2fqLIUN

Stock and bond flows at polar opposites after Trump win

Bank of America analysts describe this week's flows as "violent rotation" and "bond bloodbath"
bit.ly/2hvJAk3

CUSTODY & FUND SERVICES

Deutsche Börse and Bundesbank present blockchain prototype

The pair plan to develop the prototype further over the next few months
bit.ly/2hptd5Z

Clearstream & DekaBank launch settlement solution

Clearstream, DekaBank, TARGET2-Securities, T2S, CSD, ICSD
bit.ly/2hF9cHt

BNY Mellon wins record UK local gov bond deal

Aberdeen City Council bond issue is the largest to be issued by UK local government entity
bit.ly/2hfSWQd

RBC I&TS to provide custody services for iBionext

iBionext specialises in the funding and development of innovative healthcare companies.
bit.ly/2hlUUw6

GFT working with Lombard Risk on collateral

Part of GFT's remit is to link the technology with Lombard's core COLLINE platform
bit.ly/2hfNigK

ALFI strikes Australia deal for Luxembourg funds

Move set to enable Australian institutional investors easier access to Luxembourg UCITS funds
bit.ly/2hlOjEC

UBS to use new T2S tool

Model combines best of central securities depository and agent bank services
bit.ly/2hw5jbN

Unprepared regulators obstructing blockchain

Integrating blockchain with existing regulatory and legal frameworks seen as the biggest challenge preventing its adoption
bit.ly/2hlZYAe

HSBC announces new sustainable finance unit

Christian Deseglise will lead an international team from London
bit.ly/2hvZGKy

Credit Suisse switches to BNY for ADR programme

Credit Suisse has appointed BNY Mellon as the successor depositary bank for its ADR programme
bit.ly/2hvYTcu

Visit *globalinvestormagazine.com* for the latest news and analysis on asset management, asset servicing and securities finance

INTERNATIONAL SECURITIES FINANCE

Trump administration to spark sec lending opportunities
US election result likely to generate new trade ideas and revenue opportunities for lenders
bit.ly/2fBLSK2

John Hancock mutual funds switch to Citi's sec lending service
Citi's agency lending desk to provide stock loan services
bit.ly/2hpsDoQ

SFTR on the radar for IHS Markit
IHS Markit says it has the "pedigree and relationships" to help the industry with SFTR
bit.ly/2hIZz0W

ING Capital Markets unveils synthetic PB platform
Many investment banks have enhanced their synthetic finance capabilities in recent years
bit.ly/2hptqGi

Deutsche Bank to cut clients from trading business
Firm to reduce services it offers to over 3,000 clients in debt and equities trading
bit.ly/2hpAa77

Variation margin collateral will be 'huge challenge'
March 2017 EMIR enforcement date may expose a global shortage of collateral
bit.ly/2gsEwln

SFTR to bring trades out of the shadows, says EquiLend
EquiLend's Iain MacKay speaks about EquiLend's plans to simplify SFTR
bit.ly/2hm0gaH

Pivotal year ahead for banks in 2017, says Morgan Stanley
Reflation restructuring and regulatory clarity should allow for more confident returns
bit.ly/2hpvXzX

Beneficial owners urged to engage
Experts urge asset owners need to understand the complex interaction of regulations
bit.ly/2gRAEBv

Linedata revamps portfolio management tool
Enhancements ensure asset managers and hedge funds can meet increased reporting requirements
bit.ly/2hvYkQ9

EMERGING MARKETS

South African fund boutiques gain ground on larger rivals
Challengers, including managers such as Visio, Truffle, 36One have been the winners
bit.ly/2gsvifb

Abu Dhabi Securities Exchange sees rise in foreign and institutional investment
The upgrade of ADX on MSCI index has helped attract institutional investors
bit.ly/2gRos3M

GCC bond markets spurred by cheap oil
Developments in Saudi Arabia and the UAE suggest that sustainable, liquid GCC bond markets are taking hold
bit.ly/2hpsku6

EMs vulnerable to reflationary US policy
Inflation and subsequent interest rate hikes could lead to an exodus from emerging market risk assets
bit.ly/2hIX8eU

Shanghai, Shenzhen add to list of lendable stocks
Shenzhen is the world's ninth-largest stock exchange by market capitalisation
bit.ly/2gEnvhL

Hong Kong brokers pick Fidessa for Shenzhen Connect
Builds on its success with Shanghai Connect program to deliver Shenzhen
bit.ly/2hfNkWb

Santander buys back asset management business
Santander Asset Management operates in 11 countries across Europe and Latin America
bit.ly/2hINxaM

Kenyan officials look to finalise securities lending rules
Kenya's CMA is in final stages of developing securities lending and borrowing regulations
bit.ly/2gsOA3S

South Korea toughens short selling rules
Changes announced by the FSC to come into force in early 2017
bit.ly/2gsGAA3

EMAIL ALERTS
Register at globalinvestormagazine.com to receive free news alerts straight to your inbox

Facing the future

ESG investing has grown in stature due to research showing it improves returns, says *Merle Crichton*. But can this continue under the new world order?

Institutional investors are increasing taking environmental, social and governance (ESG) considerations into account when setting their strategies. Around a third of institutional investors and professionals now consider it to be a source of alpha generation and risk mitigation, according to research by RBC Global Global Asset Management.

"Clearly investors are giving greater weight to ESG criteria, not only in equities but increasingly across all asset classes," says Kathryn Saklatvala, a director of bfinance and co-author of a separate study that found increasing sophistication in how policies are being applied. The universe of products and strategies is shifting away from negative screening towards bottom-up factor integration and active engagement.

It is not hard to see why. Although interest may initial be attracted to doing the right thing – especially for trustees of public institutions' pension schemes – there is a growing body of research showing that returns are positively impacted by ESG considerations.

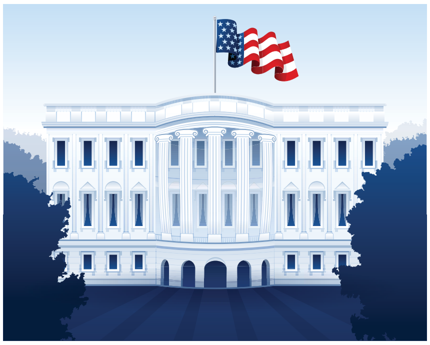
Research from MSCI published in December found that ESG scores had positive correlations with size, quality and low volatility. Its results showed that integrating ESG criteria into passive strategies generally improved risk-adjusted performance over the period 2007 to 2017 and titled the portfolio towards higher quality and lower volatility securities.

When ESG was integrated into factor strategies, MSCI found that significant improvements in the ESG profile of these strategies was achieved with relatively modest impacts on target factor exposure (the degree of impact depending on the strategy).

Investor appetite

Investors are taking note according to Hermes Investment Management, especially in the realm of infrastructure, which Peter Hofbauer, head of the asset class, describes as "inherently sustainable".

He says, for example, that his firm's 2015 acquisition of a 40% stake in Associated British Ports (ABP) in



To have applied ESG principles a decade ago would have put you on the correct side of history and rewarded you accordingly

conjunction with the Canada Public Pension Investment Board (CPPIB) was underpinned by "solid financial reasoning" but also "the beneficial holistic outcomes we expect to achieve over the life of our investments". In addition, in the case of ABP, "investing in future decarbonisation trends such as renewable energy will hedge against the changing usage its ports will experience as old carbon-intensive energy imports decline".

There will certainly be a home for money seeking a home in emerging markets. McKinsey estimates that between 2015 and 2030 $89trn will be needed for sustainable infrastructure development and UNOPS is developing a business line to channel the money.

"One of the major stumbling blocks for private sector investment is the short pipelines and slow pace of progress in developing bankable projects," said UNOPS executive director Grete Faremo at a speech in early December. "We have taken the initiative to develop a seed capital approach to convert early stage or stranded projects into investable proposals."

Turning tide

The seemingly unassailable rise of ESG under the Obama-led international order faces a big challenge: Donald Trump. Globally, the last decades have seen increasingly tight environmental standards, subsidies for zero-emission cars, cooperation against money laundering, liberal trade deals and generous international aid. To have applied ESG principles back then would have put you on the correct side of history and rewarded you accordingly.

While the president-elect should be given the benefit of the doubt, his nomination of renowned climate change sceptic Scott Pruitt to head the EPA does not bode well. The COP21 Paris climate change agreement, which Trump described as "a bad deal for America", is now almost certainly dead. Indeed, non-renewable carbon stocks have seen a huge boost after the election.

The challenge now facing ESG is whether it can still add to returns, or even not harm them. It may be right to care about such issues regardless, but the movement will lose its ability to claim outperformance if investors lose out on an oil bonanza. ESG has had most resonance with trustees of defined benefit pension schemes which, in the UK at least, have an obligation to maximise returns for the beneficiaries. It will certainly make it more difficult for them to justify their investment strategies.

The art of the deal

An increasing number of asset owners are taking the step up from tailored mandates to full-blown partnerships with asset managers. *David Rowley* details the growth in this trend

In a world where banks are pulling back from their traditional funding role, there is an ever-growing number of opportunities for asset owners to fill the gaps. The number of partnerships between asset owners and asset managers has been gathering pace over the past five years and involvement is no longer the preserve of giant pension funds.

In the aftermath of the financial shocks of 2008 large funds decided they wanted more control over their destiny and were also unhappy with fees, according to Luba Nikulina, global head of manager research at Willis Towers Watson. "The asset owner community became more aware of the overall bias in the structure where most of the value created goes to the asset management industry rather than the asset owners," she says.

Any allocation the C$300bn Canadian Pension Plan makes with a fund manager is so large it is best structured as a partnership

There was also a realisation that a large tailored deal with a fund manager, particularly in the private assets space, made more sense than having an ever-increasing number of manager relationships.

An entry-level deal involves the direct supply of a significant sum of capital for an opportunistic deal at relatively short notice. It often stems from a friendly agreement with a private debt manager. This helps a fund manager that does not have time to secure a group of smaller investors to provide the same sum and it can also be more appealing than partnering with a rival manager.

The next stage up is a more formal structured deal. Here, the asset owner can often be seen to be taking the initiative, accept more of the risk and have the upper hand.

In October 2016, the New Zealand Superannuation Fund became a significant investor in Boston-based Longroad Energy Holdings, which focuses on the development of wind and solar energy generation in the US. It followed the 2014 deal between the Californian Public Employee Retirement System (CalPERS) with UBS Global Asset Management to purchase global infrastructure through the creation of a new fund management firm funded with 97% capital from CalPERS and 3 percent from UBS.

Indeed, for the world's gargantuan funds, such partnerships are a fact of life. Almost any allocation the C$300bn Canadian Pension Plan (CPP) makes with a fund manager is so large it is best structured as a partnership. In 2016 it formed these relationships at a rate of one per month; bringing patient long-term capital to the table attracts plenty of willing suitors. One example was a 25% stake worth $375m in the Raffles City China Investment Partners III fund, which will invest in Chinese gateway cities. To help service such deals in the region, CPP has an office in Hong Kong.

It should also be noted that many relationships do not get publicity, especially those between hedge fund managers and asset owners. For some asset owners, managers such as Bridgewater not only offer diversification of returns but detailed and expert advice on macroeconomic issues.

The $7bn question

But can smaller funds do such deals? Andrew Drake, a partner in pensions and investment consulting business at PwC, says that they typically only start to make sense for funds that are over $6-7bn in AuM.

Such AuM constraints leads to regional disparity. Pension funds from countries that have scale take advantage of large funding opportunities in other developed nations where funds lack scale. The €161bn PGGM fund has 40 years of experience in investing in build-to-rent housing in the Netherlands; the more atomised UK pension fund market does not have an equivalent. So, when Legal and General Capital recently sought a partner to build £600m of flats to rent in the UK in 2016 it turned to PGGM

Similarly, North American and Swedish pension scheme members will stand to benefit from the deal between the First Swedish National Pension Fund (AP1) and Second (AP2) and TIAA-CREF to create TH Real Estate a pan-European office investment platform committed to building €4bn of offices in London, Paris, Munich, Hamburg, Frankfurt and Berlin.

Hong Kong crackdown

Officials have proposed a tougher set of reporting rules for asset managers engaged in securities lending, repos and OTC derivative trades. *Andrew Neil* takes a closer look

In their quest to position Hong Kong as a major international asset management centre, financial officials have been keeping a close eye on the development of international standards. At the end of November, the Securities and Futures Commission (SFC) announced proposals to introduce a tougher set of reporting rules for fund houses.

The proposals are in line with post-crisis moves by international bodies such as the International Organization of Securities Commissions (IOSCO), the Financial Stability Board (FSB) and other watchdogs. A huge volume of policy recommendations have been published with implications for the asset management industry, covering both public and private funds.

Reforms generally relate to areas such as systemic risk, shadow banking, liquidity and risk management, enhanced custody requirements, securities lending and repos, and reducing conflicts of interest. All strive to enhance financial stability and produce better investor outcomes.

The series of proposals sent out by the SFC, headed by CEO Ashley Alder, focused on securities lending, repo, custody, liquidity risk management and disclosure of leverage. All areas were marked for enhanced reporting.

"A robust and responsive regulatory regime is fundamental to the development and growth of an international asset management centre," said Alder, who has also been the chair of IOSCO since May. "It is important to ensure that our regulations are properly benchmarked to evolving international standards."

To address so-called shadow banking risks, the SFC is arguing that amendments be made to the Fund Manager Code of Conduct (FMCC) in relation to firms engaging in securities lending, repos and similar over-the-counter (OTC) transactions on behalf of funds it manages.

Proposals include requiring asset managers to establish an eligible collateral and haircut policy, to set out the types of collateral it accepts and disclose its calculation of haircuts on the collateral it receives. A cash collateral reinvestment policy that ensures assets held are sufficiently liquid and low risk to meet recalls could also be required. It is also proposing that additional documentation of securities lending and repos in annual reports and fund literature are produced.

"If implemented, the SFC's proposed amendments to the FMCC and the enhanced disclosure requirements in the SFC's Code of Conduct (COC) will increase the compliance burden for Hong Kong asset managers and intermediaries alike," said William Hallatt, Hong Kong-based partner at law firm Herbert Smith Freehills. "That said, the amendments are aligned with the general regulatory shift towards greater transparency in financial markets, particularly in relation to fees and conflicts of interest."

Custody, liquidity and leverage

The SFC is also calling for the latest standards established by IOSCO last year in relation to the custody of fund assets. In particular, securities must be segregated from the assets of the fund manager and, where fund assets are held in a client omnibus account, the fund manager must ensure that appropriate safeguards are put in place to ensure the assets belonging to each client are appropriately recorded and reconciled.

Managing the liquidity risk of a fund, an increasingly important aspect of fund management, is another focus of the SFC. Accordingly, it proposes requiring fund managers to maintain and implement effective liquidity management policies, having regard to the investment strategy, liquidity profile, underlying obligations and redemption policy of the fund.

In addition, the SFC is suggesting that fund managers disclose the maximum level of leverage that they employ on behalf of each fund they manage. This would involve taking into account financial leverage arising from borrowing assets and synthetic leverage arising from the use of derivatives.

Alder said that SFC officials are "mindful of the need to strike a proper balance" between facilitating market development and competitiveness on the one hand, and ensuring protection of investors' interests and market integrity on the other. "We have conducted extensive soft consultations on the proposals with different industry stakeholders and received general support," he added.

Hong Kong fund managers have until the end of February 2017 to give their thoughts on the SFC's plans, which coincide with similar regulatory efforts in other jurisdictions. In the US, the Securities and Exchange Commission (SEC) is putting in place new rules requiring more frequent and detailed fund reporting requirements around securities lending and repo activity for certain US investment funds. Meanwhile, in Europe SFTR will force firms to report details of their securities financing transactions (SFTs) to trade repositories from mid-2018.

Index-huggers beware

The UK regulator has identified a swathe of market where high fees are charged for small degrees of active management, reports *Alastair O'Dell*

The UK Financial Conduct Authority (FCA) set out proposals to combat weak price competition in the active asset management industry in November, having identified a large proportion of managers charging high fees without adding value – or even attempting to do so.

The long-awaited interim results of its asset management study looking at value for money in the £7trn AuM UK industry highlighted a section of the market where funds take modest positions, defined as those with a tracking error to the benchmark below 1.5, but charge high fees.

The report stated that there is around £109bn of expensive funds that "closely mirror" the performance of the market but are "considerably more expensive" that passive funds. It was just the worst example in a report full of uncomfortable statistics.

The FCA found that, on average, costs are not justified by higher returns. It considers this to be evidence that competition was failing. Christopher Woodward, the FCA's director of strategy and competition, said: "Active charges have remained broadly the same for the last decade whereas there is some evidence that passive funds' fees have fallen.

"For active funds there is also considerable price clustering... If we put that together with the fact that in the industry there are consistent and substantial profits over time it would suggest that rather than being an efficient price for the market it is actually more like a going-rate."

Despite there being a large number of market participants there were spikes in the distribution of charges around 1% and 0.75%, which would not be expected in a competitive market. There was no suggestion of any organised price fixing or collusion in the industry.

There are two broad groupings where the FCA was comfortable with the fees being charged. It considered competition to be working effectively for passive managers tracking an index at a low price, with an ongoing charges figure (OCF) at or below roughly 0.5, and active funds taking significant positions with an OCF of up to 1.5%.

"Rather than being an efficient price for the market it is actually more like a going-rate"
CHRISTOPHER WOODWARD, FCA

It concluded that investors are not getting adequate information to make decisions, stating that objectives were not always clear and the appropriate benchmark is not always applied. Indeed, the report identified a shocking level of ignorance among retail investors: 49% were not even aware that they had paid any charges on their most recent investment.

Andrew Glessing, head of regulation at consultancy Alpha FMC, said: "For the first time the regulator has laid out its expectations of the sector and is challenging the fundamentals of the asset management model in a way not seen before, in its aim to see greater value delivered to the end investor.

"We can expect greater scrutiny on corporate governance and strategy. Further, there will be heavier burdens of responsibility on senior management, a need for enhanced product governance, and active fund managers in particular can expect more external pressure from stakeholders as the FCA intervenes to drive price competition."

Ed Francis, EMEA head of investment at Willis Towers Watson said: "Managers must be accountable for consistently demonstrating the value they add relative to fees, and ensure that their interests continue to be closely aligned with the needs and requirements of schemes and, ultimately, end-savers. As the FCA considers potential remedies to address these concerns, it is important that any further regulation does not fall onto investors in the form of higher costs."

The FCA has targeted the enhancement of transparency and competition as the remedy, rather than seeking a charges cap or engaging in naming-and-shaming (market practices are generally within the law). In line with the FCA's competition powers, the interim report laid out evidence and provisional remedies. It will now consult on its findings, with the aim of publishing a final report in the summer of 2017.

The EU's PRIIPS Regulation, expected to apply from January 2018, tackles similar issues but Woodward said that the FCA will go further in its recommendations.

Time to face the facts

The FCA review does not mean active management is dead, says *Daniel Godfrey*, but it urgently needs to reform itself to provide better value to investors

Eight years after the global financial crisis, the spotlight has well and truly swung from banks to asset managers. Banks now have to meet capital requirements, face stress tests every year and, in Europe at least, they're not allowed to pay employees more than 100% of their salary as bonus (200% with shareholder approval).

The UK FCA's review of competition in asset management made for uncomfortable reading. It is tempting to interpret it as a clear statement that you'd be mad to ever invest in active funds; that you would be much better off in passive funds.

But that would be a false assumption.

Passive funds certainly have their place. But active investment management should and must have a major role in the investment industry of the future. Indeed, it is vital that active investment management as a whole reforms itself. If it does, it will deliver both the long-term returns that ultimate beneficiaries need and, through the long-term allocation and stewardship of capital, deliver those returns in ways that have a strongly positive impact on the economy and society.

> **"Active investment management should and must have a major role in the investment industry of the future"**

The FCA is not challenging the validity of active investment management, but its review is certainly a major challenge to the status quo. One problem for active management is that the sum of the active management industry cannot outperform the market over time. There's nothing that can be done about that.

But another major problem is that a very significant proportion of the active management industry is part of a capital market chain that is short-changing both the ultimate providers of capital and the economy. And something can be done about that.

The problems are hard-baked into the current system because of perverse incentives and excessive intermediation, which leads to short-termism and a replacement of long-term investment by trading and speculation. It's been a very safe place for the industry to be. Even since the crisis, the industry's AuM has doubled. Revenues, profits and pay have all risen so there has been precious little impetus for significant change.

End of benchmark-hugging

But now the pressure is rising. The FCA's review, media comment and the work of the Transparency Taskforce among other factors is creating a window of opportunity for change. Active investment managers who respond appropriately can better serve beneficiaries, society and their own shareholders.

The FCA's proposed prescriptions of stronger governance and sunlight will hasten the end of active management that cleaves closely to a benchmark. Frankly, if what you want is to beat an index by a bit every year – forget it. You'll almost certainly be better off in the long run by just finding the cheapest way of replicating it.

When investors, advisers and active managers are solely focussed on not underperforming the index by too much, perverse effects ensue.

A manager that underweights a stock is rewarded with relative outperformance if that stock underperforms the market. But I am at a loss to understand why I should pay an active asset manager to buy shares in companies that it thinks are going to do badly.

A manager that underweights a stock also has no incentive to engage with the company board to try to initiate improvements – as success negatively impacts the manager's relative performance. This leaves companies with significant proportions of their shareholder base disengaged.

The FCA's proposed rule that asset managers should always act in the best interest of their client will be hard to meet under that model.

The future for active lies in high conviction, low turnover, long-term, high-engagement styles where managers offer a distinctive differentiation from passive or smart beta strategies. This will also lead to more active stewardship for better long-term outcomes not only for beneficiaries, but also for employees, innovation, tax transparency and corporate integrity.

Many good managers recognise the systemic pressures that inhibit long-term thinking and diminish returns to investors and society. But the capital market system is highly resistant to radical change.

That's why The People's Trust, which has crowdsourced its set-up costs from over 2,000 founders, is being established as a mutual enterprise. With no external commercial shareholders and no bonus schemes for employees, it should be able to avoid conflicts of interests and put its shareholders' long-term interests first every time.

Daniel Godfrey is the founder of The People's Trust and a former head of the Investment Association

Handle with care

Derivatives are a valuable addition to institutional investors' toolbox but making mistakes can be expensive. *David Rowley* investigates best practice

Derivatives often allow institutional investors to manage risks and gain exposures in a more cost-effective way than is otherwise possible. But it is a realm of the financial markets that asset owners may not access directly very often, and the specialist knowledge required has been further complicated with new margining rules. Huge pension schemes may have a dedicated in-house expert while smaller ones need to cope with appropriate internal controls.

In the litany of poor uses of derivatives by institutional investors, paying too much for downside protection figures highly. "I do not believe you should buy protection following the market all the way to zero. You should only pay for the insurance you need," says Masroor Ahmad, managing director, derivatives, River and Mercantile Group, a provider that offers these services.

Likewise, if the equity market goes sideways over a five-year period an investor paying for any form of equity option will have done worse than the market.

One can take the philosophical stance that paying for such insurance gives investors the confidence to maintain a higher exposure to equities than would otherwise be the case, but it has become much easier to model insurance cover. In this way, the amount of downside an investor wishes to avoid and the amount of upside it is prepared to give away can be tailored to match its own forecasts for the market, the rate of return it requires, but also to match their budget.

Ahmad believes this process puts pension trustees in a greater position of power and saves time on understanding the language and practice of derivatives traders. "Rather than trying to understand the delta [ratio] and the vega [volatility] of your option, you need to know how to govern the structure and the investment manager," he says.

Forced unwinding

One common way of paying too much for derivatives is if they are unwound before the contract ends. Many of the commentators for this article spoke of the punitive penalties imposed by banks in this regard. Some funds have even had contracts unwound when they had wanted them to continue.

Philip Bennett, a partner at law firm Slaughter and May, notes that there are little observed clauses that allow counterparty banks to close out a derivatives deal. These are being employed opportunistically by banks, he says, that are facing increasing pressure from regulators to cut the levels of risk they are taking.

Bennett has seen this happen for clients that are in a pooled arrangement with other funds for interest rate and inflation swaps. Where one pension fund defaults on a margin call to the counterparty bank, the bank has the right to close off the whole arrangement that includes all other funds. While this is costly and no doubt frustrating Bennett describes not having greater protection from such get-out clauses as an error on the part of the funds involved.

"There are pension funds out there with agreements of this type that are blissfully unaware of the issue," he says. "If you are looking at a stressed bank, all legal rights get exercised that you would ordinarily not commercially exercise."

Generally, the bigger the fund the more it is aware of the need to stress-test for counterparty risk, says Bennett. "Not all of the risks in extreme stress circumstances are sufficiently articulated."

It is illuminating then to see the lengths the largest funds go to monitor their derivative use.

CalPERS's stated list of control

> **"Rather than trying to understand the delta and the vega of your option, you need to know how to govern the structure and the investment manager"**
> MASROOR AHMAD, RIVER AND MERCANTILE GROUP

procedures covers: accounting and performance measurement; compliance controls; the monitoring of market risk exposure, liquidity needs and counterparty risk limits; and the evaluation of operations to ensure use of proper systems, controls, staffing and staff qualifications.

NZ Super sets maximum exposures to counterparties based on credit ratings. It also sets out the responsibilities of key individuals in relation to derivatives, a list that covers the roles played by its head of operations, legal team, chair of investment committee, head of portfolios and CIO.

APRA, the main regulator of superannuation funds in Australia, emphasises that trustees must set an objective for using derivatives. This may sound simplistic, but the importance of such objectives were tested in the large volatility seen in global markets in January 2016.

Most Australian super funds typically have allocations to equities of around 60-70% and for many this was an opportunity to cash in options. Media Super was one that did, making a profit on its overall hedging strategy if not its overall portfolio.

At times like these, some super funds find that there were conflicting views internally on whether they should cash in on the price of their options and make a profit, or hold on to them for an even worse scenario.

QIC, one of the key providers of options to the Australian market, says buyers must understand the full consequences of selling options. Neil Williams, investment director at QIC, says that whenever a fund introduces or withdraws an option, it is effectively changing its asset allocation by either raising or lowering its exposure to equities. This, he believes, should be factored into any decision.

"If you think you've hit a level of the market where it no longer makes sense, or you want to realise the money that you've made on the option, and you sell the option you are effectively raising your equity exposure," he says.

At such times, it can help to have an experienced practitioner in the organisation. Since 2008 many large funds have taken in ex-investment bank employees who have a deep understanding of how derivatives work. Notably, Ron Mock, chief executive of Ontario Teachers' Pension Plan, previously directed sales and trading staff in derivative products.

"The benefits of gilt derivatives versus swaps is you get a higher yield, but the downside is that you need to roll them periodically and the financing cost of doing so varies over time"
PATRICK CUNNINGHAM, CARDANO

Collateral concern

Another challenge for investors is not focusing on the risks of managing collateral. This has become a serious concern for interest and inflation rate swaps as there is widespread belief that interest rates are now on an upward trend, increasing the call by banks for more contingent assets from investors.

If pension funds lack sufficient cash or gilts to post as collateral the risk is they will have to sell return-seeking assets to plug the gap.

Patrick Cunningham, partner and head of client management team at Cardano, advises funds to always stress-test the amount of collateral they have for this reason. This is a problem that has grown acute as banks are demanding a higher proportion of collateral for derivatives than they have in the past due to the higher capital ratios their businesses must hold now. Ten years ago, banks would demand collateral of 10%, but figures of 35-40% have become more normal.

Another issue resulting from record low interest rates is that with gilts now cheaper than swaps many pension funds are stopping the use of interest rate swaps and moving to gilt derivatives such as gilt repos or gilt total return swaps.

"The benefits of gilt derivatives versus swaps is you get a higher yield, but the downside is that you need to roll them periodically and the financing cost of doing so varies over time," says Cunningham. "With a swap you knew what you were getting for 30 years – you did not need to roll it and the costs were embedded it."

The increased costs come from rolling contracts up to several times a year. At each point market volatility might mean a higher cost than expected or an inability to strike a deal.

David Wrigley, partner at LCP, says banks are now generally charging more for unwinding positions, particularly for special or non-standard contracts. This could impact any fund looking to unwind a long-term liability hedge if it finds another way to hedge, if it wants to pass its liabilities to an insurer or if large numbers of members transfer out.

"If terms are non-standard then exit costs can be high as a bank would need to either find another party to take on those non-standard terms, take on the risk themselves or unwind hedges the bank may have in place," says Wrigley.

ASSET MANAGEMENT: APPOINTMENTS


Doug Stewart

OppenheimerFunds has named **Doug Stewart** as head of its European, Middle East and Africa distribution. The appointment supports the growth of OppenheimerFunds' international platform, which includes the recent launch of an Ireland-domiciled UCITS-fund offering. London-based Stewart will be responsible for marketing and distribution efforts throughout EMEA.

Daniel Melley has joined **Putnam Investments** to spearhead the firm's institutional business across EMEA. London-based Melley joins from Winton Capital, a $30bn hedge fund, where he served as global head of consultant relations. He will now oversee Putnam's institutional sales and consultant relations in EMEA and report to Jeffrey Gould, head of Putnam Global Institutional Management.

Lombard Odier Private Bank has appointed **Michael Le Garignon** as head of independent asset managers (IAM) UK, a newly created role. The move follows the continued investment plan of the Geneva-based asset manager to expand its presence in the UK. Based in London, Le Garignon will be responsible for driving the launch of Lombard's IAM solution in the UK.

Abigail Johnson is to succeed her father Edward "Ned" Johnson as chairperson of **Fidelity Investments**, following the retirement of the long-standing chairman. Ms Johnson will become chairman of the family-run firm in early December. She became chief executive in 2014 and will continue that role alongside.

Amundi, Europe's largest asset manager by AuM, has appointed **Laurent Tignard** as head of multi-assets for institutional clients and Raphaël Sobotka as head of multi-assets for retail clients. Both based in Paris, Tignard and Sobotka report to Vincent Mortier, global head of multi-assets and deputy chief investment officer (CIO) of Amundi Group. Tignard joins from Edmond de Rothschild Asset Management, where he was CEO for three years.

IFM Investors has appointed **Paul Burraston** as business development director for North America. San Francisco-based Burraston will be responsible for developing new business opportunities for IFM - a $56bn fund manager owned by 29 Australian pension funds. He will also oversee relationships for all asset classes including infrastructure, debt investments, listed equities and private capital.

Aris Prepoudis has been appointed as the new CEO of sustainable investment specialist **RobecoSAM**. The firm – an affiliate of global pure-play Netherlands-based asset manager Robeco – announced the appointment would become effective on January 1 2017, subject to FINMA (Swiss Financial Market Supervisory Authority) approval.

Legal & General Investment Management America, has hired PIMCO's **Jordan Bond** as a senior portfolio manager for the US active fixed income team. Bond will be responsible for trading the banking and financial sectors for the US Active Fixed Income team, which currently manages over $57bn in fixed income strategies. Most recently he served as vice president, portfolio manager at PIMCO.

Russell Investments has hired **Mark Spina** as head of its US Private Client Services business. He is responsible for leading and expanding the firm's US advisor-focused business, with a focus on providing advisors with multi-asset investing solutions for their individual investor clients. Spina, who joins from Pioneer Investments, is based in Russell Investments' New York office and reports directly to CEO Len Brennan.

J.P. Morgan Asset Management has appointed its head of sovereign and institutions in Asia Pacific, **Rachel Farrell**, as chief executive and country head of global investment management (GIM) Australia. In this newly created role, Farrell will oversee all of the firm's operations in Australia and will assume direct responsibility for both J.P. Morgan Asset Management's funds and institutional businesses in the country.

Swiss-based boutique asset manager **Unigestion** has appointed **Miles O'Connor** as UK chairman. O'Connor has previously been a head of Europe, Middle East and Africa institutional business at Schroder Investment Management. He has also held senior management roles at Barclays Global Investors, where he was head of UK sales and client services, and has spent six years as head of international business development at Bank of America/WorldInvest.

Skagen has appointed Øyvind **Schanke**, former chief investment officer for asset strategies at Norway's Government Pension Fund, as chief executive officer. Schanke will take up the role on 1 February, 2017. He replaces Leif Ola Rød, who will remain CEO at the firm until 1 March to ensure a structured transition. He joins from Norges Bank Investment Management, Norway's Government pension fund, where he has served as chief investment officer for asset strategies since 2014.

Dutch asset manager **NN Investment Partners** (NNIP) has appointed **Maureen Schlejen** to head institutional relationships in the Netherlands. The new role is intended to put more resources into the Dutch market. Schlejen, who joins the firm on 1 January, comes from Robeco where she worked for 20 years in Dutch asset management.

Reporting beyond reason

ESMA is considering whether to force the segregate AIF and UCITS client assets well beyond the client-facing depositary level. This would only increase costs and errors, says *Merle Crichton*

The European Securities and Markets Authority (ESMA) has been strongly urged to abandon the strict interpretation of the segregation of client assets throughout the custody chain. While the industry has welcomed enhanced standards and accepted tougher regulatory reporting, extending segregation by asset type all the way down the sub-custody chain is surely a step too far.

The introduction of the Alternative Investment Fund Managers Directive (AIFMD) and the UCITS V Directive, introduced in July 2014 and March 2016 respectively, left open the interpretation of the segregation of client assets.

"It is an open point of AIFMD and UCITS V," says James Farrugia, partner at Ganado Advocates. "Do we need to segregate AIF assets, UCITS assets and assets belonging to other clients all the way down the custody chain or not?"

While it has been decided by ESMA, and accepted by the industry, that assets must be segregated into UCITS, AIF or other investor groups at the client-facing depositary level – which is liable for assets losses – it remains undecided whether this must be maintained at non-client-facing levels of sub-custody below the depositary.

The asset segregation regime is designed to ensure that the ownership of assets is clearly identifiable and robustly protected in the event of an insolvency. ESMA is considering the responses to its consultation, which closed in September, ahead of submitting its re-drafted technical standards to the European Commission. ESMA, which unusually consulted twice on the issue, has demonstrated a bit of backtracking, according to a panel at the Global

Custody Forum in London in December, but the issue remains of great concern to market participants.

"If EMSA adopts a hard position, it is because it does not recognise the distinction between segregation and omnibus structure," says Farrugia. He added that the regulatory institution "seems to be unable to see how these two principles can work together on the level of protection for the assets".

The industry consensus seems to be that asset segregation according to investment vehicle type beyond the client-facing depositary does not serve a purpose except to increase risk of error. "If we had segregation down the chain in UCITS assets, for example, I think it would only create more operational risk," says Farrugia.

Farrugia notes that clients might need separate accounts for tax reclaim purposes but segregating them just for the sake of having "different buckets all the way down the custody chain" is "useless".

"At the end of the day, the entity which needs to maintain proper records of the ownership of those assets is the custodian or depositary that is facing the client," says Farrugia. "The custodian needs to do its job and ensure its contracts are robust. There is already a clear obligation under AIFMD and UCITS V that the depositary facing the client must be satisfied and undertake extensive due diligence."

Habib Motani, partner at Clifford Chance, says that the issue was not the segregation of client assets from those of the custodian, "that is a given", but whether it is beneficial to segregate at all levels of sub-custody in terms of vehicle type. "Once you have a segregated block, whether you divide that block into three individual segregated blocks or leave it as one block, it makes zero difference to the protection element. It does nothing apart from add cost and operational issues."

Susan Wright, regulatory and compliance specialist at the Investment Association, was in agreement: "I can't see at the moment why there would be any benefit to introduce further risk," she says. "I think asset managers are going to rely more and more on their custodians. In some, but not all cases, custodians are now doing what they should have been doing in terms of liabilities, responsibilities and who does what."

While enhanced asset segregation rules provide comfort for clients and protect against the build-up of systemic risk, not every measure will create a material benefit. While the industry can be prone to grumbling about new rules being imposed, this time it is right.

Don't break the blockchain

Regulators could needlessly hold back the promising application of blockchain in post-trade services out of misplaced fear, says *Andrew Neil*

Major banks, start-ups and established market infrastructure firms, including CSDs and exchanges, are all making large scale investments in distributed ledger technology (DLT), commonly known as blockchain.

There are myriad potential use cases but so far much of the attention is being focused on cutting costs and improving efficiency in the relatively straightforward post-trade world, the pipework of the capital markets where securities are settled and stored.

Blockchain applications are diverse both conceptually and geographically. Consortium R3 is partnering with Calypso Technology on a trade confirmation solution. Led by UBS, four banks and broker ICAP are working on a prototype virtual currency used to settle mainstream financial markets transactions with hopes to launch in 2018. Euroclear is developing a system for settling gold trades. In Japan, the dominant sub-custodian Mizuho Bank and Fujitsu have reached the proof of concept stage with a solution to streamline cross-border settlement.

However, the current regulatory and legal environment isn't built to facilitate the widespread use of DLT in the post-trade space and regulators, including the FSOC in the US, are warning that it potentially poses risks to financial stability. European securities watchdog ESMA is also focusing on blockchain but has not yet taken a public position on the desirability or practicalities of using DLT for post-trade services.

> "At first, principles-based regulation may be particularly suitable at this early stage in the adoption of DLT"
>
> PAUL SYMONS, EUROCLEAR

In a recent whitepaper by Euroclear and law firm Slaughter & May, head of government relations at the ICSD Paul Symons wrote that regulators should not fear the use of smart contracts and DLT any more than any other automated computer-based process prevalent throughout the settlement industry – all of which are vulnerable to mistakes in the underlying coding architecture.

However, he noted that two key regulatory questions need to be resolved. In a distributed system, who should be held responsible for operational failures? And, when a mistake is spotted, how should it be rectified?

The role of CSDs

The house view at Euroclear is that DLT in securities safekeeping and settlement could yield substantial benefits including reduced settlement latency, reduced operational and custody risk, increased transparency and date security as well as reduced intermediation of recordkeeping.

"In our view, CSDs could have an important role to play in a blockchain-based settlement system," said Symons. "As custodians of the code, CSDs could exercise oversight of, and take responsibility for, the operation of the relevant blockchain protocol and any associated smart contracts."

At the same time CSDs must ensure that, irrespective of the technology they use, they continue to meet their existing (and numerous) regulatory obligations and standards under, in particular, the CSDR and the CPMI-IOSCO Principles for FMIs. Euroclear's legal experts argue that that use of blockchain by a CSD should not by itself trigger a need for any new specific regulatory approvals.

"We believe that there are two approaches which regulators could adopt now, while ensuring investor protection and systemic stability," Symons added. "At first, principles-based regulation may be particularly suitable at this early stage in the adoption of DLT, compared to [rules-based] black letter law. Principles are more flexible and easier to modify in response to unforeseen issues as the technology beds in."

Secondly, and perhaps in parallel, Euroclear suggest regulators could work with firms to foster disruptive innovation in this area and to help firms overcome the significant monetary, technical and regulatory barriers to wide-scale adoption of DLT in this industry.

Blockchain solutions could provide significant savings that would result in the removal of latency and redundancies in the system to the stronger guarantees of reconciliation.

Jorma Yli-Jaakkola, director of Euroclear's legal department added: "There is much for regulators and market participants to like about a blockchain-based settlement system. Therefore, how to foster innovation in this area is a pressing question for regulators and market participants alike. The open issues will need to be addressed to the satisfaction of the market, in terms of efficiency, and regulators, in terms of security and safety."

The blockchain paradox

Paul Dowding, Gartland and Mellina Group, says current blockchain designs are unable to provide real-time solutions, but a solution is technically possible

In one of his famous paradoxes, the ancient Greek philosopher Zeno tells us how Achilles decides to race a tortoise but allows it a head start. When the race begins, Achilles runs to where the tortoise started but finds it has already moved. He then runs to the point where the tortoise moved to, only to again find it slightly ahead. This cycle continues until Achilles finally gives up exhausted, unable to ever overtake.

Current blockchain solutions in the financial services industry have their own logical paradoxes to overcome. A blockchain ledger needs a validation mechanism, yet this introduces capacity constraints and latency, which, like Achilles, means it can never catch up with real-time processing.

While Bitcoin, the original use of blockchain, dealt with simple transfers of ledger-referenced value, Wall Street's full set of interdependent products and lifecycles represent an Olympic pantheon of events.

Additionally, current blockchain solutions require an ever-expanding continuous record in order to access any prior transactions and balances, which ultimately generates a storage requirement that is not viable. Not only has the blockchain to catch up; it also faces a continuously moving target. This problem has no – at least publicised – solution and often is described conferences as "being worked on".

Consensus algorithms

In order to increase the speed of processing and validation in the ubiquitous consensus algorithm, the industry is looking at various innovative ideas that include sharded consensus (a divide-and-conquer mechanism to create a quicker, fragmented, trusted-node consensus) and lightning networks (where transactions are agreed outside the main blockchain and then recorded in it later). While there are benefits of these solutions they cannot support the real-time transactions that are critical for market-making or algorithmic trading and execution.

No use cases yet exist for truly complex transactions. While there are current use cases involving repo, syndicated loans, credit default and interest rate swaps that may be complex in terms of structure, valuation and monitoring, they are all over-the-counter (OTC) transactions. Such OTC transactions are based on low-volume, unregistered securities where settlement is predominantly for payment streams. These merely represent customised versions of the simplest use cases.

In addition to the speed, capacity and scalability challenges, there are also complex market interdependencies to consider. Consider a fund manager selling a bond when that bond had already been put out on loan by the custodian, the borrowing broker had passed it on to a hedge fund, the hedge fund sold it short, and the buyer from the hedge fund is a money market fund. There is no easy way to represent that complex interdependent settlement lifecycle in a ledger-referenced system.

Rather than iteratively enhancing initial, basic blockchains, a blockchain solution designer has to address the challenges that are required to support the whole financial services industry. If a blockchain solution cannot address all of these challenges, it will have limited use and benefit to the industry. These include:

- A flexible means to code and control multiple lifecycles
- Ledger processing and validation that allows for scalability and real-time capacity
- Confidentiality of shared records
- Dual, bi-directional asset settlement as with FX or DVP/RVP
- Financing and liability-driven transactions
- Short, payable and unbacked future-dated transactions
- The ability to interact with current markets or other blockchain networks
- A simple means to allow for all the downstream monitoring, analysis and reporting required of the industry

It is never the case for technologically-driven processes that the solution is first built and then scalability, flexibility, sustainability and reliability are added afterwards; they have to be intrinsic to the design.

The solution to Zeno's paradox was provided by Sir Isaac Newton using ingenious and fundamentally-derived differential calculus. New, fundamentally-derived blockchain designs have been defined as those that can overcome these challenges and have the potential to succeed and be adopted universally. This is possible – the apparently unresolvable blockchain paradoxes are only within the current blockchain solutions and not the principles upon which blockchains are based.

Paul Dowding is the managing director, blockchain solutions lead, of the financial services strategy and solutions practice of Gartland and Mellina Group (GMG). GMG has filed a provisional patent application to develop unique, holistic, blockchain solutions for the financial services industry, which are product, transaction and functionally agnostic and collectively represent a Blockchain utility.

Technology takeover

Jeff Conway, CEO of State Street for EMEA, speaks to *Alastair O'Dell* in his first major interview since returning to the region about how technology is transforming custody and fund services

It has been 18 months since Jeff Conway returned to the UK after a decade in his native US and is now firmly settled into his role of CEO of EMEA, with regional responsibility for the Global Services, Global Markets and Global Exchange businesses. He has brought back a zeal for technology and is leading a root-and-branch overhaul of business processes.

Europe has not, in the meantime, had a stellar year. Brexit and market turbulence have only added to the daunting prospect of complying with an unceasing barrage of compliance demands. "Our clients need us now more than they ever have. We need to be relentless in our ability to deliver for them."

To "relentlessly deliver" is a phrase that Conway repeats during the interview, describing the need for his business to support clients in increasingly challenging times. Testing for sure, but also circumstances where the best prepared can pull out an advantage.

Not every industry trend or regulatory change will benefit State Street but Conway takes the view that there is now no point fighting the inevitable and effort is best spent getting ahead of the curve. "Just accept it – regulation is not going to go away. We have our own regulatory requirements but our clients have their own and we need to help them. I looked at the level of demand that our customers were looking to from us – and it continues to be quite high."

Strategic direction

There is an array of possible strategic directions for the truly global custodian banks. Primarily due to regulation, there are unresolved questions of what is required of trust banks, new opportunities left by investment banks curtailed by capital constraints and areas where clients need additional support.

"Where there is confusion, there are real opportunities," he says. "On the back of market change there is opportunity for us to introduce a new set of capabilities. Our ability to position the organisation while remaining nimble enough in areas of change is going to put us in a good place."

For example, State Street's enhanced custody product was launched as a result of regulatory constraints hitting prime brokers. Enhanced custody, run by Alex Lawton's team for EMEA from London, provides short supply to the market alongside (rather than competing with) prime brokers, many of which are constrained by Basel III and would perhaps rather concentrate on activities attracting less capital cost and greater revenue.

Waiting for certainty before starting the development process would mean products would not be ready when clients' needs arise. "We are going to have to take some bets – for lack of a better word – in advancing new innovative solutions. It isn't always going to be a clear path. But if we are smart about how the regulatory environment is driving the market then we can take some new product bets."

Data deluge

The complexity and frequency of regulatory reporting requirements has stoked demand for powerful data solutions. State Street is certainly not alone creating products to streamline vast amounts of data but Conway says that State Street Global Exchange is "doubling-down" on its solution. DataGX platform, which is already operational for Solvency II and EMIR, has the potential for far broader application.

"I said, let's look this a little bit differently. Let's invest more, be forward-looking. Let's make sure we have the resources not just for today's demand but build this out into a broader platform for the demands we think are coming."

State Street has already signed up clients to DataGX, which allows them to internalise and consume a variety of data, including from other custodians. "It is the leaping-off point for us offering a broader range of data-analytic solutions within Global Exchange. If I can solve my client's data aggregation challenges – and do that as an extension of our current services relationship– there will be tremendous opportunities to innovate into new spaces alongside our clients."

It is a strategy that could harness many market trends. For example, the move towards multi-asset class vehicles means liquidity monitoring is becoming a critical function. Indeed, the US SEC is looking into liquidity management around subscriptions and redemptions. Says Conway: "If you consider complex investment strategies with subscriptions and redemptions coming in every day – what scenarios could impact the liquidity position of the fund?"

Likewise, the trend for large pension funds to insource investment management requires support. "Providing the infrastructure required for them to be able to take on these activities, and to help with the transition, increases the impact that we can have on those clients. There's a level of innovation happening across the franchise that gets us much more deeply into outsourced-CIO services."

Conversely, asset managers are looking to outsource non-core functions and face their own regulatory issues. "They want less of the infrastructure in house and to leverage organisations such as ours. Changing their operating model to support new investment strategies while complying with new regulation is a heavy lift."

Guiding light

State Street's digitisation efforts are guided by Beacon, a five year internal transformation programme launched this year. "It is about looking at things process-by-process, automating and digitising our core operating model and integrating those benefits into the end-to-end operating model with our client."

In January 2016, State Street predicted that Beacon would generate substantial ongoing savings including $75m during the year and $550m over the next five years (although there are large implementation costs). Its transformative focus moves across businesses but the theory is the same; first it rationalises overlapping applications and processes and then optimises the workforce – moving jobs to lower-cost locations and "less hands-on work" – before identifying new product opportunities.

In the context of DataGX, it meant rationalising processes and constructing a platform that allows the automated consumption of trade data. For example, it banishes the practice of collating trades into an NAV and sending end-of-day reports to clients. "In the new environment, we get our trades in a straight-through automated fashion. Our clients have visibility into its production cycle as we configure the NAV."

Ultimately, this will allow State Street to provide real-time data delivery. "We're not fully there yet, but the clients already get a cleaner set of data and more rapid delivery to their shop."

A focus on efficiency inevitably means changes to the workforce: "Beacon ultimately creates new growth opportunities and will allow our workforce to develop other skill sets versus openly pushing on reductions. Organisations have to push to create a cost advantage and part of that is automation. No question."

While he could not be accused of being overly sentimental, Conway has a very positive perspective. "What makes a winning formula is creating a cost advantage while fuelling new product capabilities. It requires a real process-engineering mindset, changing your core operating model, overlaying technology, to drive out manual intervention."

Rise of the tech guys

Automation and digitisation have increased the importance of technology experts. As *Global Investor/ISF* reported frequently during 2016, there has been a steady flow of senior industry figures to technology startups to guide systems development.

"Continuing to deepen our technology resources and attract new perspectives and skills remain a priority. Beacon reinforces the opportunity and challenge related to changes to our business model and developments required in defining the workforce of the future."

While maintaining existing business lines will require less manpower, it does not mean the total workforce will decrease. "Our digitisation effort is clearly about creating greater efficiencies in our core operating model but more importantly, it's about growth. If the digitisation effort creates new product potential, the workforce needs to introduce new skills and talent."

Already, there been a noticeable change in the type of person being hired to people with deep data analysis skills. "You need core technology developers, but also a hybrid people that can do data mapping, analyse core data sets or build new analytic models on top of data sets."

He says technology has become a core, revenue-generating part of the business. "It is an exciting prospect for people starting out in the industry."

Next steps

While last year's industry buzz-word 'data lake' resulted in the DataGX product, the current "cool things" State Street is working on with various partners involve robotics and trading. "Part of what we're doing is creating regulatory solutions for EMIR, MiFID or KYC. But at the forefront is what we're doing around cognitive learning. And we are doing some really cool things around unstructured data."

State Street has a tie-up with Media Stats that enables it to create signals for predictive analytics. Progress is at a very early stage but is "advancing at a reasonable rate" and should lead to robo-learning capabilities.

Right now, its research teams can furnish clients more predictive analytics and "it's a space that we're continuing to push and advance". For example, its risk analytics tool can be used to identify opportunities that emerge as a result of interaction between seemingly unconnected markets. While these tools remain mostly of use to chief risk officers they will become increasingly useful to portfolio managers as the tools approach real-time.

"We have to invest in the future – and we certainly are. We recognise that the industry is changing and we need to change at a more rapid rate than ever."

You can be sure Conway will be relentless in facing the challenge: "You can never have an end game."

Cross-border construction

A variety of EU fund vehicles have sprung up in recent years and some are now experiencing rapid cross-border growth, finds *Paul Golden*, but home-country bias still dominates

There has been a mixed response from investors to recent European fund vehicle launches, with investors in many countries retaining a bias towards buying domestically-domiciled products.

The structure generating the most excitement in the UK is the Authorised Contractual Scheme (ACS), which brings the UK into line with the tax advantages offered in Luxembourg and Dublin in so-called tax-transparent funds. A Northern Trust survey of UK-based finance professionals found that around half expected the value of UK ACS funds under management to exceed £250bn by next year, with almost a quarter predicting that as much as £500bn could be invested by the end of 2017.

A spokesperson for the Investment Association says there is growing interest in this structure, most notably from the pensions sector as an alternative to master trust funds and as a pooling vehicle for local government pension schemes, with the 89 schemes in England and Wales set to merge into six super funds in the next few years. As of the end of October, 78 ACS funds had been authorised by the FCA.

There is potential for very large assets levels to be gathered once the market has adjusted to what the structure offers, suggests Calisan, adding that apart from tax benefits, the ACS also offers a wide range of transparency advantages across fund rationalisation, regulatory reporting and distribution.

BNP Paribas Investment Partners head of external distribution UK Mike Woolley says the vehicle has proved to be more popular with charities and pension funds than with private investors "for whom the administrative requirements have posed challenges". However, HSBC head of tax product securities services Ed Turner says this is not indicative of failure in the vehicle's design.

Uncertainty in the UK fund market as a result of Brexit means the government's plan to create an ideal UCITS master-feeder structure has taken a blow, continues Turner. "Those asset managers previously looking at the ACS for UCITS master-feeder structures for cross-border distribution may now be forced to instead look at similar vehicles in Europe. That said, without the ACS local government pension scheme and UK life company assets would be flowing offshore."

In a separate move by the UK, in June the Treasury published a response to feedback on its July 2015 proposals to amend UK limited partnership law, with the intention that the changes would be fully operational within a year. The objective is to promote the UK limited partnership as a market standard structure for European private funds and maintain and enhance the UK as a competitive fund domicile.

According to Sascha Calisan, head of fund distribution support at Northern Trust, this vehicle has the potential to help the UK make up ground on Ireland and Luxembourg as an international funds base, particularly in the private market investment space.

"The partnership structure is more recognised in the US than in the mainstream European financial centres, but there will always be a good use for the structure, particularly for institutional or more sophisticated investors," she says. "With appropriate government support, it will provide a flexible and transparent alternative to existing vehicles."

FCP & SICAV

Morningstar data indicates that Europe-domiciled *Fonds Commun de Placement* (FCP) had assets of almost €1.8trn at the end of October, while assets in *Sociétés d'Investissement à Capital Variable* (SICAVs) were just under €2.6trn (the two Luxembourg open-ended collective investment structures only differ materially in terms of the legal entity, which has tax implications).

However, Woolley suggests that neither have gained significant traction in the UK partly because of the requirement to report all fund holdings as though they were direct holdings for tax purposes. Both structures are platform compliant,

but are not available on all platforms.

The head of product management at a major global bank is more dismissive, suggesting that there is nothing inherent in these structures that would persuade an investor to abandon their domestic bias. "This is also the case in other European countries – the removal of historical barriers does not change buying patterns overnight. Investors in France, Spain and Germany are even more domestically-biased than those in the UK," he says. "The transparency and protections inherent in MiFID will change attitudes, but it will take time."

ELTIF & RAIF

Views on the potential of infrastructure-focussed European Long-term Investment Funds (ELTIF) and Luxembourg's AIFMD-compliant Reserved Alternative Investment Fund (RAIF) also diverge.

Pat Lardner, chief executive Irish Funds expects demand for ELTIF to grow, recognising that it is a specialist product in terms of investment focus and the term over which investors' capital will be deployed. "The policy imperative and positive link to the Capital Markets Union project are clear and while it is still very early days, we have seen indications of interest from some managers already investing in the infrastructure space and also those interested in targeting the mass affluent market," he says.

There is interest from the asset management community in establishing products that can attract investment from ELTIFs in the future, says Paul Heffernan, HSBC's head of cross-border sales, Europe, securities services. "We expect the ELTIF market to grow steadily, although it may take some time for investors to fully appreciate the advantages and apply them in their portfolios," he says.

Levels of demand will depend on liquidity, how investments are viewed for capital risk and the treatment for the fund over the long term, says Calisan, who warns that the various tax treatments in different countries across the EU may make the fund harder to sell.

Dominic Johnson, chairman of the New City Initiative also says there is limited interest in ELTIFs as they are hamstrung by a number of factors and suspects they might be slow to catch on, following the path trodden by similar European fund initiatives such as EuSEFs (for social enterprises) and EuVECAs (for venture capital).

"Despite being a retail AIFM, ELTIFs have a high investment threshold which disenfranchises a number of potential clients," says Johnson. "Also, ELTIFs have exposure to infrastructure, real estate and private loans – these are illiquid assets and require investors to be locked into the investment for up to seven years, which does not appeal to retail market."

> **"Despite being a retail AIFM, ELTIFs have a high investment threshold which disenfranchises a number of potential clients"**
> DOMINIC JOHNSON, NEW CITY INITIATIVE

He says the motivation for creating the vehicle was that it might be embraced by mid-sized pension funds or insurers lacking the wherewithal or knowledge to invest in infrastructure. European regulators have sought to encourage this by easing the Solvency II capital requirements for insurers with ELTIF exposure.

On the other hand, Luxembourg's track record of creating popular, well-regulated fund structures bodes well for RAIFs. Calisan describes it as an interesting addition to Luxembourg's range of fund structures expected to offer greater flexibility and improved time-to-market over other options, while in the opinion of Heffernan it is further evidence of Luxembourg's presence at the forefront of the fund wrapper development curve.

ICAV

Another structure that has met with almost universal approval is the Irish Collective Asset Management Vehicle or ICAV. More than 290 vehicles have been launched so far with assets of €25.5bn as of end of September, positive net flows every month and ICAVs being used both for UCITS and AIFs, says Lardner.

"The vast majority of these have been in respect of new fund registrations," he adds. "We expect the number to continue to grow strongly in respect of both new funds and increasingly in relation to existing funds converting from other Irish investment funds structures."

Calisan observes that ICAV has been termed one of the most significant developments in the Irish fund industry, with the structure providing flexibility to investment managers operating funds in Ireland by offering legislative advantages and potential tax efficiencies.

"The ICAV has become the legal structure of choice in Ireland for both UCITS and non-UCITS vehicles," says Heffernan. "The significant majority of new umbrellas being established are being set up as ICAVs and platform managers are seeing the most benefit given the changes to accounting requirements."

When asked whether Ireland's collective asset management vehicle has generated as much business as expected, Johnson notes that it appeals to managers and investors by effectively checking the box for US taxable investors, enabling them to be treated as tax-transparent entities. "There has been a number of high profile fund managers converting to ICAV structures and the feedback has been positive," he concludes. "We expect the ICAV to gain traction going forward."

CUSTODY & FUND SERVICES: APPOINTMENTS

HSBC has appointed **Gina Slotosch** as head of securities services, Germany. She is based in firm's Dusseldorf office and responsible for driving the growth and development of the division which provides custody and securities lending to German clients. Slotosch first joined HSBC in 2005 to lead the securities services sales and business development teams in Germany and later moved to London as head of product for HSBC's global distribution and transfer agency unit. Before joining HSBC, she held a number of securities services positions at State Street, Deutsche Bank and BNY Mellon.

Blockchain firm **Paxos** has added the former chief executive of the New York Stock Exchange to its board. **Duncan Niederauer**, a thirty year financial services veteran, served as the head of NYSE from 2007-2014 and was previously a partner at Goldman Sachs. His appointment follows a series of post-trade settlement collaborations involving Paxos, including a deal with Euroclear to create a blockchain settlement service for the gold market. itBit officially rebranded as Paxos earlier this year.

David Rydderch has been named as the new global head of **Deutsche Bank's** alternative fund services business. The business, which sits within the firm's securities services division, offers a range of tools to hedge funds, fund of funds and other alternative investment vehicles. These include regulatory reporting, collateral management, liquidity financing, FX and derivatives. London-based Rydderch has been with the firm for eight years.

Tim Howell is stepping down as the chief executive of post-trade giant **Euroclear** after six years at the helm. Howell, who redefined the firm's business model by focusing heavily on IT and collateral management, will be replaced by **Lieve Mostrey** at the start of 2017. She was hired by Howell from BNP Paribas six years ago as the company's chief technology and services officer.

US post-trade giant **DTCC** has hired **Jim Hraska** as a managing director and general manager of the group's Fixed Income Clearing Corporation. Hraska joins from Barclays where he served as global director of product management specializing in financing and structural reform. He is now tasked with leading the DTCC's fixed income clearing efforts to reduce risks and costs in the US fixed income markets and attract buy-side members to DTCC's platform.

Northern Trust has appointed **Caroline Higgins** as head of its global fund services business in Asia. Based in Hong Kong, Higgins will focus on bringing Northern Trust's range of fund solutions to Asia-based investment manager clients. She will also focus on helping the firm's existing clients distribute their products across the continent. Higgins joins Northern Trust from Brown Brothers Harriman (BBH) where she was head of transfer agency for Asia.

RBC Investor & Treasury Services has named **Rosemarie Kriesel** as managing director, global client coverage in Hong Kong. Kriesel, who had previously worked in Luxembourg, Bermuda and Canada before moving to Hong Kong in 1993, joins from BNY Mellon. She has spent 10 years working for the US custody bank's global client management team and was country executive for Hong Kong. Reporting to Andrew Gordon, managing director, Asia, RBC Investor & Treasury Services, she will be responsible for all client coverage, including fund managers, asset owners, banks, brokers and exchanges in Hong Kong.

ICAP has hired Goldman Sachs' former European head of OTC clearing to head up post-trade product development. **Stuart Connolly** has joined ICAP's Post Trade Risk and Information (PTRI) division in a newly created role as head of client product development, reporting to PTRI's CEO Jenny Knott.

Intercontinental Exchange has appointed of **Lee Yi Shyan** as chairman of ICE Futures Singapore and ICE Clear Singapore. Yi Shyan is a member of parliament in Singapore and previously served in the Singapore government over a ten year period as a senior minister. Prior to this, between 2001 and 2006, he served as the chief executive of International Enterprise Board, an organisation promoting international trade with businesses in Singapore.

Citi has hired **Renzo Arcoria** as head of markets and securities services for India. Arcoria joined Citi in June 2010 as Head of Fixed Income Sales for Italy and in May 2012 he was appointed Head of Markets for Italy. Before joining Citi, he was head of banks and retail sales at Barclays Capital in London. Prior to that, he was the head of fixed income sales for southern Europe, Middle East and Eastern Europe at Bank of America.

BNY Mellon has elected **Linda Cook** and **Jennifer Morgan** as independent directors. With the addition of Cook and Morgan, BNY Mellon's board will have 14 directors, 13 of whom are independent. Cook, managing director of EIG Global Energy Partners, will join the firm's corporate governance and nominating and risk committees. Morgan, president of SAP North America, will join the audit and technology committees.

GoldenSource has bolstered its management team with the announcement of three new hires to support its growth across capital markets in Europe. The recruits include **Charlie Browne**, who will head up market data and risk solutions, in addition to **Haider Mannan** and **Graham Langley**, who will lead dedicated buy and sell-side sales teams respectively. Neill Vanlint, Managing Director of EMEA and Asia at GoldenSource, said the hat-trick of hires shows the firm's commitment to deepening its capabilities in the market data space – with FRTB a clear driver.

Prime positioning

Hedge fund treasury teams are starting to generate significant alpha and efficiencies for themselves and their prime brokers, finds *Andrew Neil*

Faced with tougher regulation and added financing complexity, many hedge funds have sought to build first class treasury units in recent years by adding staff, boosting automation and taking on additional responsibilities.

Analysts at Barclays Prime Services suggested the changes are starting to pay off. "We believe that the hedge fund industry has passed a tipping point," said Louis Molinari, the firm's global head of capital solutions, commenting on a recent research undertaken by the firm. "There is a structural shift from the treasury group serving as a utility to it transitioning to a unit that can generate alpha through efficiency and optimisation."

Molinari's team quizzed a group of hedge funds with a combined $400bn of assets, representing roughly 15% of the industry, as part of its recent study. It found that 80% now have a distinct treasury function – separate from operations – dedicated to portfolio financing, cash/collateral management and counterparty management.

"In the hope of becoming better partners with their prime brokers – aligning on return on assets (ROA) metrics, improving efficiency of long and short positions, and reducing balance sheet consumption –hedge funds are trending toward a centralised approach, which allows them to be more efficient and optimised with their various counterparties," explained Betty Gee, director, US head of prime services strategic consulting at Barclays.

Centralised financing

The vast majority have centralised their financing process, where their treasury team, as opposed to individual traders, are responsible for items such as locating borrows and negotiating rates/prices. Most indicated that they fully intend to continue increasing the level of automation at their firms, with investment in both internal and external technology solutions.

A clear benefit from the investment in this area appears to be the impact from proactive management of stock lending rates. This can provide substantial savings for hedge funds via better pricing and tighter ranges for their hard-to-borrow positions."

As would be expected, larger hedge funds – those with an AuM above $5bn – appear to have access to much lower hard-to-borrow rates than smaller rivals.

Taking proactive management a step further, the hedge funds in Barclays' sample indicated they are much more likely to try to optimise pre-trade relative to post-trade as they believe it is easier to negotiate prices before the trade.

More than half of the $5bn+ AuM managers polled by Barclays now use formal and transparent broker reviews as tools to decide how to allocate prime broker balances. The key factors influencing wallet allocations were trade level factors e.g. shorts/hard-to-borrow supply, execution and rates.

Barclays analysts noted in the report that, much like the trend with dedicated treasury headcount, smaller and/or single strategy hedge funds require relationships with fewer prime brokers as they either have simpler needs or less financing to spread around.

The hedge funds Barclays Prime Services spoke to indicated that their treasury functions are still in build-out mode. The three main areas they are focusing on improving are their levels of automation, sourcing technology solutions and counterparty management.

"Hedge funds are taking a holistic view of their counterparties and developing technology to ensure alignment across multiple variables with them," Molinari added. "The first step they identified was to identify the right number of counterparties, which will be based on a variety of factors, including risk monitoring / credit as well as the breadth of supply, pricing/rates, quality of service provided, and the positions prime brokers have and how those align with their portfolio."

The elusive squeeze

The March 2017 EMIR variation margin enforcement date may expose a global shortage of collateral. But there is no sign of it appearing just yet, says *Alastair O'Dell*

An impending deadline for the collateralisation of non-cleared derivatives under EMIR has reawakened fears that there may be a shortage of eligible assets to cover trades.

A number of regulations – from Basel III to EMIR and Dodd-Frank – have increased the demand for high quality liquid assets (HQLA), leading to widespread predictions a few years ago that trading would be curtailed and lending fees would spike. It did not come to pass, but there are now more solid reasons to believe the long-prophesised collateral squeeze could become a reality.

EMIR requires counterparties, which exceed certain thresholds, to collateralise non-cleared derivative transactions, with initial margin at the opening of the trade and variation margin on a daily basis. The requirements are being gradually phased in but March 2017 is a major date as this is when all counterparties will be required to post variation margin.

"This is a big bang," said Ted Leveroni, chief commercial officer, DTCC-Euroclear GlobalCollateral. "March is a huge challenge. The buy-side community and custodians see three big challenges – repapering [ISDA documentation], the increase in the volume of collateral transactions and the decreased settlement period."

The first step is to get the documentation in order to make trades legally possible. "Dealers are dealing with thousands and thousands of entities and they are going to have to repaper all of them." He says that while some firms may have the resources and "bandwidth" to cope with repapering, the entity on the other side of the trade may not and "they are going to have to prioritise".

Once all parties are fully operational we will see the new equilibrium demand for collateral. Leveroni estimates that there will be a huge increase in the volume of collateral transactions – calls could be "two, three or four times" the current level. The wildest estimates put this at 25 times the current number.

Triggering supply

While a collateral squeeze is undesirable for the smooth functioning of the market it can be alleviated through securities lending and benefit the owners of eligible assets. From a trading perspective, there has been strong and sustained demand for collateral transformation, upgrade, collateral-swap styles of trades for a number of years, says Alex Lawton, senior managing director, head of securities finance, EMEA, State Street.

"How far the perceived shortage drives this, and whether this is a real concern, really stems from what quantum of additional collateral is required. It's only then can one really say if there is a potential shortage or not."

There has not been a noticeable spike in demand in 2016 that would signify a shortage, "nor has there been a marked widening of spreads, JGB's aside, that again could be a lead indicator," he adds.

However, Bill Foley, director of Foley O'Neill, says: "Those rates had not actually kicked in as the regulations were always on the horizon. People became a bit complacent but they are very much in front of our faces right now. In terms of securities lending, there are potentially some very, very healthy returns available."

Jan Heckler, managing director, head business services asset management, Swiss Re agrees that "owners can potentially benefit from this".

The extent to which prices respond to a surge in demand will depend on the flexibility of supply; healthy returns could tempt untapped sources of HQLA into the markets. "Certainly, there will be strategic, long-term holders of HQLA assets that may wish to enter the market given appropriate triggers," says Lawton, who runs State Street's enhanced custody business.

"What will be of great interest is the chosen route to market, with bespoke structured trades and peer-to-peer playing a much more prevalent role versus the traditional repo/agency lending model."

In addition, internationally there are also sources of HQLA that have not been exhausted. For example, a change to Japanese tax law in early 2016 means that JGBs have become more attractive to be used for this purpose. At least one of the major Japanese custodian banks is pushing for their more widespread use internationally as collateral.

Lifetime achievement

Following the announcement that he is to call time on his illustrious career, Mohamed Moursy speaks to *Andrew Neil* about the evolution of the securities lending industry

For Mohamed Moursy, winner of the *Global Investor/ISF* 2016 Lifetime Achievement Award, two things stand out about the securities finance industry he has served in for nearly thirty years.

The first is the market's uniqueness; a characteristic illustrated by the intricate functions being performed and interconnected relationships seen throughout the business. The second and perhaps more important feature is the critical role borrowers and lenders now play in providing liquidity throughout the global financial system.

Both attributes have been underestimated or misunderstood at various stages, according to the industry veteran – currently UK branch managing director – capital markets solutions of ABN AMRO Bank NV, as well as chief executive officer of ABN AMRO Markets (UK) Ltd.

Moursy's experience in the securities financing industry goes back to 1988 when he joined Lehman Brothers as the firm was establishing its UK securities lending operation. "Back then the concept of global securities finance didn't exist," he explains. "We've since witnessed an evolution. The industry now contains a diverse set of organisations with bilateral arrangements across the globe." Just as the scope of business changed over time, Moursy says perceptions have also shifted.

"Securities finance is more appreciated and understood by banks, brokers and the buy side as a key source of liquidity management." This, he adds, has been driven by regulations, market dynamics, demand for high-quality collateral and a heightened focus on risk.

After leaving Lehman Brothers in the early nineties Moursy went on to work in various roles at Paine Webber, Fleet Securities, Mees Pierson and The Bank of New York Capital Markets. He joined ABN AMRO in 2002 and now manages capital markets solutions' UK trading activities, which include securities financing. At that point in time the International Securities Lending Association (ISLA) was an organisation that only catered for the agent lending community. That soon began to change and in 2006 ABN AMRO added itself to ISLA's list of members from the borrowing community and Moursy joined the board.

"Mohamed has been an active member of the board ever since, constantly pushing hard for change and for the industry to move forward," says Mark Hutchings, ISLA's chief operating officer. Hutchings presented Moursy with his Lifetime Achievement Award at the *Global Investor/ISF* dinner in London earlier this year, describing him as loyal, warm, sincere and generous.

"Over the years he has been present at many industry conferences, always vocal and never afraid to ask a question, usually the first to do so," Hutchings adds. "He is a true legend of the industry, respected by many across the globe and has survived the test of time, multiple industry events and companies no longer around – he is an industry survivor and fondly known for his greeting, 'Chief'."

Moursy, currently ISLA's treasurer, describes the trade association's decision to open its doors to borrowers as a very important move. He also praises ISLA's continued focus on education, negotiations with regulators and collaboration with groups such as the Risk Management Association in the US. "ISLA has become a clear, important and necessary voice for the market," he says.

Another characteristic of the securities finance industry that many take for granted is resiliency, according to Moursy. "The industry continues to evolve and has learned from a number of historical mistakes," he adds. "I'm encouraged by its reliance, ability to improve, evolve and meet challenges. It's undoubtedly been streamlined but has also become more client-driven. I often wonder what would happen to wider capital markets if it disappeared."

Regulation continues to be the dominant theme and will be so for the foreseeable future. The EU's Securities Financing Transactions Regulation (SFTR) is high on the agenda and one of Moursy's main work areas at present. The new rules, set to enter into force in 2018, will require firms to report their SFTs to an approved EU trade repository. "This will transform how the industry reports and participants deal with each other," Moursy suggests.

"SFTR will be a major revolution to securities finance business. The work needed to be done under STFR will dwarf Agency Lending Disclosure requirements, for example, with a documented lifetime for each transaction, unique IDs, fee changes and collateral changes. Compliance will be challenging but necessary and regulation will remain a key theme for many years to come."

Moursy, who will be retiring at the end of the year, will be truly missed.

SFTR deadline looms

The industry has a lot of work to do to prepare for the EU trade reporting regulation ahead of its 2018 implementation. *Alastair O'Dell* reports

The introduction of Securities Financing Transaction Regulation (SFTR) will be one of the biggest ever fundamental changes to the SFT industry, delegates heard at an EquiLend-hosted event in mid-December. However, the industry is only partially prepared to provide the required data to trade repositories (TRs) by the 2018 implementation date.

The aim of SFTR, as with EMIR reporting, is to provide regulators with sufficiently high quality data to identify the build-up of systemic risk. The second round of ESMA's consultation closed on 30 November and it is expected that its final draft technical standards will be submitted to the European Commission in January 2017 before being finalised.

Once finalised, firms will have 12 months to comply, starting quarterly by banks and investment firms, followed by CCPs and CSDs, financial counterparties and then corporates. The effective dates are unknown but expected to start in Q1 2018.

The panel was unanimous in expecting little or no change from the second draft text. "That has been pretty clear throughout this process. ESMA has listened and made changes where it felt they needed to be," said Laurence Marshall, COO, EquiLend.

A poll of delegates asked how prepared their organisation was for SFTR: 47% thought more analysis was required, 45% understood the requirements but were looking for a solution, and the remaining 8% was not prepared. After the event, several people confided they thought this was overly optimistic.

"The big challenge for firms is to look at how they process their business today and consider whether they can get to the required reporting through that model – I think the answer is 'no'," said Marshall. "There are going to have to be fundamental changes."

The reluctance of firms to invest in a reporting solution is at least in part due to confusion about where responsibility lies. "I do not think people are particularly clear as to the way the SFTR regulations will be finalised," said Nick Nicholls, lead consultant, GFT UK. "A number of clients are looking to see how work that they have done for EMIR and MIFID II might help them. There are a lot of unanswered questions."

Anecdotal evidence suggests beneficial owners expect agent lenders to provide a solution for SFTR, despite the obligations being on the principles of transactions. "If they have to build their own solution, I think many will question the benefit of lending and this could impact market liquidity," said James Day, managing director & business executive for securities finance in EMEA, BNY Mellon Markets. "The agent lender therefore needs to evaluate the business case and associated risks of being part of the solution set and price it accordingly."

> **"The creation of a central trade matching platform is the appropriate model in an environment where you are effectively reporting matched trades"**
>
> LAURENCE MARSHALL, EQUILEND

Patrick McManus, head of collateral resource management, Nomura, said his firm will be able to leverage its reporting systems developed for other products: "Our position to be able to provide such data is dependent on what we receive from the information providers... we just need to make sure everyone else is collectively providing the same level of detail. For us, that is a concern."

While the securities lending industry can learn lessons from similar requirements imposed on derivatives by EMIR, it also means it cannot expect the same leniency that ESMA initially provided in that market.

EquiLend's Marshall added: "Most regulatory teams do not have SFTR as their number one priority today – so it is a big challenge for everyone to get the resources they need. There is a huge opportunity to learn lessons from EMIR. We feel strongly that the creation of a central trade matching platform is the appropriate model in an environment where you are effectively reporting matched trades."

He warned that that if poor reporting could lead to the industry having to build trade reporting support teams, as has happened under EMIR. "Firms should really look to avoid that."

It is unknown how lenient regulators will be regarding punishment for poor submission of data. While there have been no fines under EMIR the regulators are making increasingly specific requests for data.

Mark Steadman, European head of product development at DerivSERV, DTCC, said: "From a trade repository perspective, I believe the regulators have learned a lot from their mistakes with EMIR. I do not expect the same process under EMIR. They recognised they were getting very poor quality data, which led to the level one and level two validations. Pre-reconciled or pre-matched trades will going to make things a lot easier. We see that under EMIR – you see much higher matching results."

Buy-side beware

Collateral management is already an important consideration for sell-side banks but many asset managers have not put in place adequate arrangements, says Delta Capita's *Jonathan Adams*

Despite considerable development of collateral management applications, utilities and services – and the potential benefits for asset managers from managing liquidity risk and meeting margin call obligations – there has so far been limited appetite from the buy-side.

The lukewarm interest has been exacerbated by the delay to EMIR's requirements on OTC derivatives clearing and the exchange of initial margin for bilateral OTC derivatives, as well as a lack of clarity on the final regulations.

In the absence of a regulatory driver, revenue considerations become critical. However, some products represent functional overkill for asset managers, appearing sell-side focused.

There are also operational risk concerns for those participating in agency securities lending programmes. This is especially the case with third-party lending and exclusive deals on portfolios, which all add complexity to the location of assets, including whether they can be recalled on time for sell orders and assessing when assets are being used for collateral purposes or in lending programmes.

Central clearing

Further muddying the water are CCPs' activities, exploring the provision of cross-margining and tri-party capabilities might further delay the choice between products. However, there are some very clear benefits for a buy-side firm to develop a collateral management capability in the short-term.

In the period leading up to the global financial crisis, there was an abundance of cheap client clearing services. Banks were almost exclusively the clearing members that provided these for high-volume plain vanilla OTC derivatives such as interest rate swaps.

This continued in the post-crisis period as regulation mandated the central clearing of OTC derivatives for most counterparties, which led to increased demand. However, banks have been burdened with being members of multiple CCPs to service their global buy-side clients. This, combined with changes to capital requirements, suddenly made offering client clearing services a less attractive revenue proposition, requiring strict compliance and monitoring.

This has undoubtedly pushed up costs, meaning buy-side clients transacting significant volumes across multiple CCPs could certainly benefit from the ability to self-clear.

Minimising yield drag

Investment and wholesale banks have traditionally been providers of liquidity to the buy-side. However, capital adequacy requirements and balance sheet usage mean that collateralised transactions versus cash have an adverse balance sheet impact, even with the highest quality collateral. Where transactions are collateralised with non-sovereign assets there is an impact on risk-weighted assets (RWAs) and capital adequacy ratios, all of which is reflected in the rates they can provide.

There is value in seeking non-traditional counterparties that don't face the same constraints, such as other buy-side entities including corporate treasury desks. In this context, tri-party looks very attractive as it enables the collateral giver to commoditise pools of assets and outsource the re-valuation, recalls and substitutions to the tri-party agent. Services such as Euroclear's RepoAccess take the headache out of negotiating individual GMRAs with each counterparty. Other products are in development so a different landscape is emerging.

Managing liquidity is a significant task for portfolio managers and being prepared for investor redemptions, managing portfolio restructuring, meeting margin call obligations, covering liquidity shortfalls and investing excess liquidity has required investment in dedicated teams and technology. Yet, with major currencies offering near zero or negative interest rates, the disparity between the yield of a strategically-invested portion of a fund and the portion that is invested in short-dated products is considerable.

The impact of the poor return from the liquid portion of a fund's NAV on the overall return, the so-called yield drag, could be partially mitigated by rebalancing the ratio of the strategically-invested portion to the short-dated liquid portion.

The transformation of strategic investment assets into high quality liquid assets (HQLA) would enable a similar liquidity ratio but offer the ability to readily raise cash against the HQLA, or use HQLAs to meet collateral obligations. The annual cost of collateral transformation is a fraction of the yield improvement gained from reducing a fund's liquidity.

Collateral optimisation has traditionally been a sell-side concern, as it is typically leveraged and focused on balance sheet usage. The focus for the buy-side is different, with a decision process that determines the deployment of expertise and resources for core activities while outsourcing non-core activities. It is imperative that collateral management is given attention so it can have an impact on the bottom line, rather than just ticking a regulatory box.

Jonathan Adams is a principal consultant and practice lead of Delta Capita

Transaction reporting under the SFTR

Pirum is creating a reporting solution to seamlessly meet the requirements of the upcoming EU Securities Finance Transaction Regulation

Article 4

Article 4 of the SFTR will require all EU entities including their branches outside the EU, as well as EU based branches of Non-EU firms, to report the details of the securities finance transactions (SFTs) they transact to the European Securities & Markets Authority (ESMA) via a registered Trade Repository (TR).

The SFTs in scope include securities loans, repos & buy-sell backs, commodities loans and prime brokerage margin loans. The requirement will become reality in 2018 with a phased roll out during the year depending on the type of firm reporting.

The SFTR is part of the regulators' mandate to supervise the financial system and where possible ensure its stability and robustness whilst adding more transparency into the securities finance market. Its aim can hardly be argued with, although the difficulties arise not in the intention of the regulation, but within the detail of its implementation.

Market participants have recently submitted their responses to the second ESMA consultation paper with particular areas of concern centred upon on value date collateral reporting, execution timestamps and the high number of mandatory reconciled fields with little or no tolerance. Pirum will be watching closely to see if any significant changes are made in the new year and will adapt our build accordingly.

The Challenge

For the traditional Agency Lending model, the most significant challenge is likely to be the requested level of reporting, with counterparties on both sides of the transaction required to report each principal allocation as a single, separate trade. This information is known by the Agent Lender but only shared with the borrower via the Agency Lending Disclosure (ALD) process which creates two immediate challenges.

The ALD information is typically provided from lender to borrower overnight on settlement date, meaning it is only available to the borrower on S+1 or several days after they are required to report the trade under the SFTR. In addition to this, the ALD process is often run on a non-disclosed basis, with only a limited number of people at the borrowing firm permitted to see the information of the principals on which they would now be required to report.

ESMA has referred back to the original SFTR text, highlighting the definition of 'counterparty' as the fund and effectively removing any possibility of the transactions being reported at the bulked agency loan level. With the current ALD process it would be extremely difficult for a borrower to successfully comply with the regulation, however there are potential solutions and Pirum already automatically handles allocation level information received in from lenders.

Another challenge will be faced at either end of the supply chain, with beneficial owners required to report SFTs to which they are the counterparty and Prime Brokers (PBs) and Hedge Funds (HFs) required to report the details of the margin lending activity. For the margin lending between PB and HF the data requested includes the portfolio of assets used by the PB as collateral for any margin loans and the loan to value ratios used in their calculations. This will be particularly challenging for HFs in scope as often this data is only stored on the PBs systems and not replicated in the systems of the HFs in a way they could then easily report.

The basic model of the SFTR reporting requirement follows some of the same frameworks set out in existing regulatory reporting regimes for other markets. Similar to EMIR, the SFTR reporting will be dual-sided. This means that the 'collateral giver' and 'collateral taker' (using ESMA's proposed terminology) will be required to separately report their version of the transaction, with both parties including an agreed Unique Transaction Identifier (UTI) on their reports. The two counterparties must use a matching UTI to allow the repositories to pair the two records upon receipt.

Legal Entity Identifiers (LEIs) will also be the de facto standard for identifying counterparts, and indeed a list of other entities involved in the transaction, including any Agent Lenders, Brokers or Central Counterparties (CCPs).

Because many of the firms involved in securities finance have existing reporting requirements under EMIR, some of the initial challenges have already been overcome. Most, if not all, will have received LEIs from their local operating units (LOUs) who are responsible for issuing them. In addition, many firms will have already incorporated these values into their client static information to use in existing EMIR and MiFID reporting.

Although existing regimes have helped prepare the market for some of the reporting standards, they have also highlighted some of the pitfalls, not least the generation and maintenance of UTIs and matched reporting. Transaction reporting under EMIR has been in effect since February 2014, and yet two and a half years later there are still significant issues with the matching of reports at repositories. The primary cause of this issue largely relates to the process of UTI creation.

A lack of clarity in how UTIs should be generated, and by which participants in the transactions, has been cited as one factor in the relatively low matching rates under existing reporting regimes. In the consultation published on 30th September 2016, ESMA has proposed a waterfall methodology to follow. This includes the use of a 'central confirmation platform' to generate UTIs which is where a platform such as Pirum will offer a solution to the market.

One advantage the securities finance market has over which some others which have preceded it for regulatory reporting is the process of contract comparison, or trade matching, which is already widely utilised. Pirum clients are already engaged in trade comparison on a real-time basis throughout the day meaning the transactions to be reported can be reconciled ready for the T+1 reporting requirement with time to spare.

The Pirum Solution

The reporting requirement under the SFTR, although substantial, can be broken down into two main components. The first is the exercise of collecting and collating the data necessary for reporting, often from multiple source systems, into a single report. The second is the matching of positions between counterparts in order to generate and apply the correct UTIs as part of that reporting. For both these tasks, the fact that contract comparison is a well-established standard within securities finance should be a significant benefit to those market participants who utilise it.

By participating in contract comparison and other post trade automation on Pirum's platform, clients are already submitting files containing many of the data points required for the SFTR reporting. As part of the comparison process Pirum are then matching positions received separately from each counterpart, effectively replicating what the TRs will be looking to do when they receive the data.

Recognising these synergies, Pirum will be building a regulatory reporting solution allowing clients to further utilise their existing file feeds by creating the SFT reportings to be submitted to the TRs on their behalf, avoiding the potentially high costs often associated with an internal build As regulatory reporting brings in no additional revenue for market participants complying with the requirement is a pure cost to the participants, and by building a solution that can be used across the market Pirum will be able to minimise the overall cost to each firm, and therefore the industry, of achieving that compliance while at the same time ensuring the reporting is of a high-quality being based on matched and reconciled data.

"Pirum is well positioned to report collateral details due to its connectivity with tri-party agents"

As part of the solution Pirum will be enhancing our market leading matching engine in order to generate UTIs from existing reconciliations. Our process will automatically generate UTIs for any matched positions which haven't already been assigned one. We will make these available to our clients through an automated feed which they can receive back into their systems allowing them to record the correct UTIs against each transaction.

We see that this will bring multiple cost benefits to our clients. The ability to re-use existing connectivity and receive automatically generated UTIs or to create the report for submission to the TRs will reduce the need to spend internal resource on both the initial build and ongoing maintenance associated with additional connections and outputs.

Receiving the UTI from Pirum based on positions which have already been matched and reconciled will provide a high level of validation pre-report, effectively ensuring that both counterparties will be submitting the same transaction with the same UTI. This will in turn significantly lower the amount of transactions that fail to be paired upon submission to the repositories and reduce the workload associated with post report monitoring and reconciliation, as well as avoiding anticipated fines for incorrect reporting.

Pirum will also offer a solution for clients to report directly to the TRs on their behalf. These clients will be effectively protected from the potential costs associated with any future changes in the required reporting content and format. If the reporting format is updated, clients will be able to continue sending their files unchanged with Pirum handling the amendments on the final report to the TR. Where new reporting fields are added we will first look to source the relevant value either from existing client files or via data enrichment where suitable.

Pirum however is also well positioned to report collateral details due to the connectivity with tri-party agents, particularly where some clients do not hold full collateral data within their main securities lending systems.

Conclusion

Development on our regulatory reporting package has already begun with the first phase due to be completed towards the end of 2016, well in advance of the first reporting dates scheduled for April 2018. If you'd like to know more about Pirum's regulatory reporting solution, please contact us directly.

Robert Frost
Head of Product Development
Robert.frost@pirum.com
Tel: +44 (0) 207 220 0961

Duncan Carpenter
Strategic Product Development
Duncan.carpenter@pirum.com
Tel: +44 (0) 207 220 0979

Robert Keane
Product Development
Robert.keane@pirum.com
Tel: +44 (0) 207 220 0967

Special situation

Nordic securities lending experts gathered in Stockholm to discuss the rise of specials and term trades and to look ahead to the impacts of SFTR and CCPs

PARTICIPANTS

Chair: Andrew Neil, associate editor, *Global Investor/ISF*
Nancy Allen, global product owner of DataLend
Steve Kiely, head of securities finance sales and relationship management – EMEA, BNY Mellon Markets
Jørgen Krog Sæbø, chief treasurer, Folketrygdfondet
Stevce Mojanovski, equity finance trader at Danske Bank
Dan Murphy, global head of equity finance, Stockholm, SEB
Per Strömberg, equity finance, Handelsbanken Capital Markets

Andrew Neil: What have agent lenders been doing to maximise client revenues in the Nordics?

Steve Kiely: The Nordics are not that dissimilar from the rest of continental Europe. We're concentrating on high-yielding stocks – intrinsic value lending. Most are focused on the 20% of the loans that make up 80% of the revenue.

We're also encouraging clients to enter into a term contracts so they can preserve their liquidity and get that extra pick-up. Collateral is not king any more. Collateral is only queen, term is king.

Neil: Jørgen, do you see these trends within in your own lending programme?

Jørgen Krog Sæbø: Yes, absolutely. Term trades are increasingly popular and profitable. It used to be one-month and now its three-month term trades. We're definitely seeing more evergreen structures. It may not be a big proportion of our trades, but we're seeing increased demand for them.

Per Strömberg: I agree. When it comes to maximising revenues we see the market turning towards longer term trades. It started with the term on cash for different reasons, but now it's more term equities and term fixed income.

Neil: Are these trends reflected in the data you have, Nancy?

Nancy Allen: It's interesting when we look at the Nordics and how the region fits into the global securities lending picture. As of September, the average lendable securities in the region totalled $282bn daily, which is approximately 7% of $3.6trn lendable European securities. To date, the average on-loan in the Nordics is approximately $34bn, which is again roughly 7% of the on-loan that we've seen across Europe.

In the second half of 2015 the Nordic market was roughly 60% to 65% general collateral (GC). So far in 2016, that percentage has dropped to 30% on average, so we've definitely seen an increase in specials trading this year.

Dan Murphy: The Nordics has a lot of specials to offer compared to mainland European countries, which are concentrated in certain sectors and certain markets. The returns are a result of very name-specific and sector-specific stocks. In Finland its construction and mining. In Denmark we've seen shipping and construction. Norway has produced energy specials and in Sweden it's been IT and industrials. Fingerprint, for example, has generated significant revenue for those lending out positions.

You'd expect most mainstream indexes to be filled mainly with GC stocks, but probably only about 50% of the names in the HEX Index could almost be guaranteed to be GC borrows, the rest of them are specials. Participants in this region are in quite a privileged position.

Kiely: 2016 has been a specials-driven revenue year. We've done particularly well in the US. Although volumes have shrunk somewhat, the specials have made up the revenue. In part, the volume declines are due to equity volatility at the

start of this year and shrinking balance sheets in general which has subdued equity finance demand.

Murphy: Hedge funds have been more inclined to sit on their cash rather than take any particular view on the market because of the recent unpredictability. There have been a lot of events, both economic and political, this year that have made it a difficult market to invest in – both on the long and short side. Names with intrinsic value have really buoyed up the rest of the market. In the coming months it's going to be interesting to see what the state of the market really is once you scratch away some of those names from the surface and look beneath. Who has got the viable clients, the ones still looking at strategies that will keep the business rolling forward? Or, if you're reliant on lending one name, will your programme struggle going forward?

Neil: Can securities lending still give value-add to large Nordic pension funds in the current environment?

Sæbø: Yes, it can definitely add value. We have a dedicated treasury department that tries to specialise in different types of non-core strategies that take advantage of who we are as an asset manager. One of these strategies is securities lending. I think more pension funds will lend their assets now, especially in this low yield environment. In Norway, there have been some changes in regulation that have made it easier for other pension funds and asset managers to start to lend their assets.

Kiely: In the last couple of months I've spoken to a pension fund in the Nordics and an insurance company in continental Europe that haven't lent before, or certainly haven't lent for quite some time. When asked about their motivations, they responded, very clearly, that the search for yield is everything. In previous years the industry spoke about percentages, not basis points (bps). Now clients are saying even if securities lending returns a few extra bps on the fund, it's worth it. They need something to try and compensate for the natural drags, such as negative interest rates.

Allen: Pension funds are increasingly focused on managing their programmes as efficiently as possible. They are open to considering refinements to their programmes, but will do so cautiously to ensure adherence with internal guidelines and corporate governance issues. For example, when considering collateral, a fixed income-only fund may be reluctant to accept equities as collateral as equity securities are not an approved investment type. Some funds may restrict lending to ensure they can vote. Occasionally, that means missing out on opportunities to participate in certain types of profitable trades.

Stevce Mojanovski: I agree to some extent. In conversations I've had with potential lenders they make the point that, based on the total revenue on the books, the returns don't look significant. The majority of the lenders I've spoken to are willing to lend on an ad hoc basis and try to extract the most value of that specific position only, rather than a full-fledged solution.

Kiely: I'd agree with that. We have a number of custody clients that lend specials as and when they want to but are not in a generic lending programme.

Murphy: The days of the exclusive have gone for the time being. If clients realise that 90% of their revenue is coming from 10% of stocks, why would they put up with the risk of having the whole portfolio out on loan? If five loans go out and make the same amount of money, they're going to be satisfied. As a borrower, in that sense, you can be both happy about that but also a little frustrated because there will be other opportunities, other types of trades, away from just the intrinsic value trades where the payback

"Automation and technology are critical as they provide efficiencies and in the long run reduce cost"
NANCY ALLEN, DATALEND

looks quite low but once you package it all together there's actually quite a decent return to be made.

Kiely: I agree and often try and get that across to the beneficial owner community in order to make them see where the value is for the borrower. I like the Nordics because, with all due respect, you don't hear a 'no, we don't want to do that', you get a 'we're not doing that until we better understand it'. We have more productive discussions here than in some parts of continental Europe in that respect.

Potential clients often revisit their initial uncertainty to lend when they look at the return to lendable, instead of viewing securities as a three or four bps return on the whole portfolio. For example, if you lend out half a dozen specials you're actually getting 3- 4% return to lendable in a trade that is more than 100% collateralised to a very good name in terms of borrower credit. I don't know where else you can get that sort of return on a fully-collateralised basis with such low risk.

Murphy: It's important for everyone in this industry to consider how we present pricing. Clients often expect a wall of admin before they can get lending and borrowing arrangements started. There's a price for administration. If they look at the headline number, which happens to be half a bp, then straight away they're doing calculations in their heads that show that back office costs are going to be ten times higher and small incremental revenue that might be earned won't cover that.

Kiely: That's an interesting point for the beneficial owners. If operations become too costly, lending may seem burdensome. Is that a difficult balance?

Sæbø: Yes, absolutely, especially in the last couple of years. We have seen an increased focus on cost saving and we have to look at every new strategy in a cost-benefit type of way. Securities lending can be very heavy operationally and back office intensive, so we have to look at the costs in relation to what we can earn.

Neil: Indemnification appears to be changing the way fee splits are shaped. Is this occurring in the Nordics?

Kiely: The Nordics drive a hard bargain because, by and large, the Nordic beneficial owner tends to be better informed and aware of the detail. Obviously the more information you have puts you in a better bargaining position. It's no secret that all the agent lenders are offering two tier pricing – one fee split if you want indemnification against borrower insolvency and a better fee split if you don't because the indemnification costs in regulatory capital. BNY Mellon has lending clients in this region that are indemnified and others that are unindemnified. The unindemnified clients get a better fee split. They are happy with that risk/reward after having looked at what they're lending, what their collateral is, who their borrowers are and the governance of the programme.

Murphy: It comes down to the client's sophistication level – unindemnified clients must be quite sophisticated. In such cases it is probably more important for them to secure a larger fee split when they're quite comfortable with their own internal assessment of the credit risk and counterparty risk when they lend.

Kiely: As Steve said earlier, if you're only putting out a dozen trades a year to earn a couple of million dollars, then you can afford to take that position because of low utilsation. I sometimes think there's a feeling among fund managers that there's a lack of control and that everything is going out.

Mojanovski: We've seen that a lot. Historically, in terms of education, there isn't a problem. But people still feel that they might lose control because their stock is out. Then again, if you conduct lending on an ad hoc basis, 15 trades a year, for example, you have full control.

Allen: In many ways it's about the bottom line. If revenue is significant enough, a beneficial owner may feel comfortable investing in its own oversight and therefore may elect to forgo agent lender indemnification in favour of a preferable fee split. However, if the beneficial owner doesn't have the resources to invest in a certain level of internal oversight, then it may choose to keep the agent's indemnification, and the fee split could be reflective of that additional protection.

Kiely: It certainly depends how active the lender is. We've had some lenders recently phone up and pull borrowers from their approved borrower list. A few years ago, or pre-crisis even, that would

never happen, they'd just leave that up to the agent lenders especially when they were indemnified. There's undoubtedly more active participation.

Murphy: I totally understand that from the agent lenders' perspective, the off balance sheet exposure that indemnification creates needs to be accounted for and is something that you have to put a price on.

Kiely: Going forward, I see securities lending programmes becoming more fragmented and more diverse – at the moment a client may have a fee split of 80/20 across the whole programme. They are either indemnified against borrower insolvency or they're not. These things are very binary, very black and white. However, I believe we may get to a stage pretty soon where a certain fee split exists for one type of trade and another fee split for a different type of trade. Some trades are indemnified, others aren't. This borrower is indemnified, that borrower isn't.

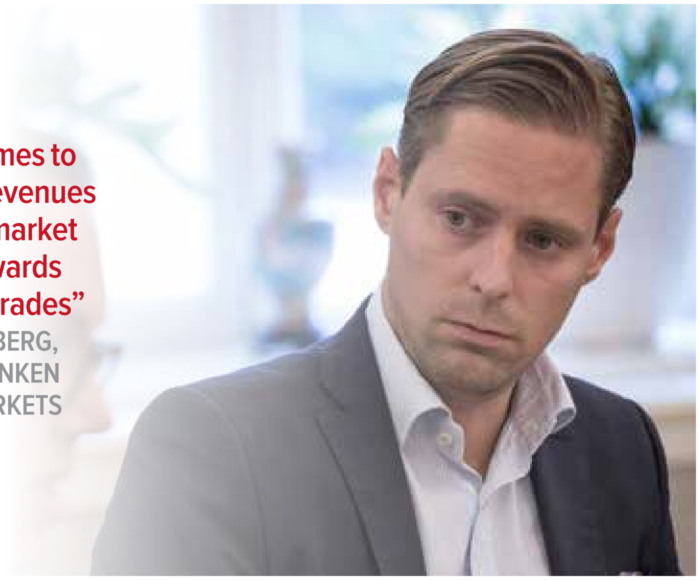
Then, if that client uses a CCP for certain trades, they might take the view that they don't need indemnification. That's a lot of IT development for the market but that's the way I believe it's going to go.

Murphy: It's certainly a lot of IT work. But compare that with no change. If the asset managers consider that the fee splits are increasingly moving away from being in their favour, they're going to look at other routes rather than via an agent lender. They might explore peer-to-peer lending, for example, or take on extra work internally and lend on a principal basis.

Allen: Automation and technology are critical as they provide efficiencies and in the long run reduce cost. Lending programmes are becoming more expensive to run as capital charges increase and programmes become more fragmented.

Neil: Are you starting to see more interest in peer-to-peer securities finance transactions?

"I think more pension funds will lend their assets now, especially in the low yielding environment"
JØRGEN KROG SÆBØ, FOLKETRYGDFONDET



"When it comes to maximising revenues we see the market turning towards longer term trades"
PER STRÖMBERG, HANDELSBANKEN CAPITAL MARKETS

Kiely: The house view at BNY Mellon is that peer-to-peer trades will be an added extra, starting with internalised trades. Situations, for example, where an asset manager is long cash but his treasury department is short cash and between them they can't optimise that because of their legal entity structure. Generally, liquidity concerns will push the industry towards all sorts of different avenues and peer-to-peer lending is one of them.

Neil: Is there increasing interest in the Nordics for central clearing?

Sæbø: I would say no. I haven't seen much talk about CCPs in the Nordics and for us it's more up to the banks to drive adoption. We're comfortable with the counterparties we have. It's not that beneficial for us to use a CCP at the moment.

Murphy: It will depend on volumes. If, as we mentioned earlier, funds are focused on trading a limited number of names and intrinsic value lending then the business isn't going to go with CCPs. I don't see widespread CCP adoption happening any time soon, especially in the Nordics. Perhaps it will in markets where there's considerable GC flow or significant financing trades running through the books.

"The Nordics drive a hard bargain because, by and large, the Nordic beneficial owner tends to be better informed and aware of the detail"
STEVE KIELY, BNY MELLON MARKETS

Allen: EquiLend has always said that when the market is ready to use CCPs, we would be ready to support them. We've been hearing from the market the need now exists. As a result, we now provide connectivity to Eurex Clearing in Europe, and we also recently acquired AQS, which provides connectivity to the OCC's stock loan central clearing service in the US. We have seen considerable interest in the new EquiLend Clearing Services business. DataLend is well positioned to start reporting on CCP trades and will be able to provide price transparency across CCP and non-CCP trades, allowing the market to quantify the benefits of a CCP.

Kiely: Yes, that would paint a useful picture for the client. In my experience, beneficial owners with a knowledge of CCPs in other markets are more comfortable. If a beneficial has never used a CCP, then it's a brave new world.

Mojanovski: From a data intelligence point of view, Nancy, have you seen greater interest in CCPs in Europe compared to the Nordics?

Allen: We have seen significant interest from a number of clients, but there are some technological obstacles that they need to overcome before going live.

Kiely: We are looking to conduct test trades before the end of the year with Eurex and are aiming to be live in the first quarter of 2017. We're currently looking at four CCPs, two in the US and two in Europe.

Neil: SFTR could be incredibly costly and time-consuming for the securities finance market to implement. What are your thoughts on the requirements and the work involved?

Sæbø: Any transparency is good for the business in general. Of course, you have to weigh it up against the costs and I'm not that familiar with how much the cost is under SFTR. But I do think the benefits could outweigh the costs.

Kiely: This is one of those services that beneficial owners expect the agent lender to provide. We will do everything we can, as one of the world's largest custodians and agent lenders, to help our clients.

Allen: Conversations around SFTR are similar to the original discussions around CCPs. Our clients are asking us about potential solutions. From a data perspective, the transparency will be significant and really enhance the market performance measurement tools that are available today.

Neil: Is EquiLend looking at providing a trade repository solution for SFTR?

Allen: While EquiLend is not planning to become a trade repository itself, we are working on a solution to streamline the SFTR reporting process for our clients. Given EquiLend's position as a front-to-back service provider spanning trading, post-trade and market data, we are in a unique position and feel we are the best-placed service provider to support clients in their SFTR reporting.

Murphy: It isn't a major surprise that this regulation has come about. In some jurisdictions SFTR-style reporting already exists so that the authorities have a good idea of what trades are being printed and in what kind of volumes. That being said, people shouldn't underestimate how big SFTR is. At SEB, we have a much more centralised view on regulation. The group that is handling all our MiFID requirements also has SFTR on its radar.

Mojanovski: I fully agree with what's been said here. It is not surprising this regulation is arriving now. It's another one on top of the others. It makes sense, because it brings transparency to the securities finance market, which is still regarded as opaque by some outsiders.

Neil: What's the current state of the Nordic hedge fund industry? What trends are you witnessing in terms of launches, strategies and returns?

Murphy: We see a pretty healthy pipeline of launches. Moreover, the funds that have been set-up for a couple of years are starting to build a little bit of a track record and are attracting more investments. This is obviously good, not just for them and us, but for the market generally. There is a niche in the market for hedge funds, especially with the lack of available yield at the moment.

Strömberg: We've seen a lot more demand lately, especially around synthetic needs as opposed to classic borrowing.

ISF: NORDIC LENDING ROUNDTABLE

Neil: There has been a big focus on dividend arbitrage trades in Denmark lately. Will these types of trades be fully phased out now?

Murphy: From what we hear in the market there has been less and less appetite for these types of transactions for the past few years. Intrinsic specials are very much in vogue and, to be honest, that's a good trend from our point of view as it matches our business model.

Mojanovski: Yes, I definitely agree. From a trade perspective the environment is changing, the world is changing and we're changing. Many years ago people thought there was going to be some kind of tax harmonisation in Europe, while obviously that hasn't happened now the local authorities are doing something about it. That's a fresh way of looking at it.

Kiely: Certain types of trades have come under a number of pressures. For example, there have been some fraudulent activities which are nothing to do with this market but unfortunately have tainted it. This is especially true in the Nordics and all these things accumulate to depress the whole market. PR and bad press affects thinking in the Nordics quicker and deeper than it does in the rest of Europe.

Neil: Lastly, what's your outlook for the Nordic securities finance market?

Sæbø: This year has been an extremely good year for us with many specials and good volumes. We're also a favourable counterparty for banks. We're optimistic about our business going forward.

Murphy: I'm also positive. There's still a strong demand for securities finance. Even after some of the events this year, clients are looking to do more business. The willingness of international hedge funds to speak to Nordic counterparties and Nordic hedge funds' forays into the European specials market are both good trends.

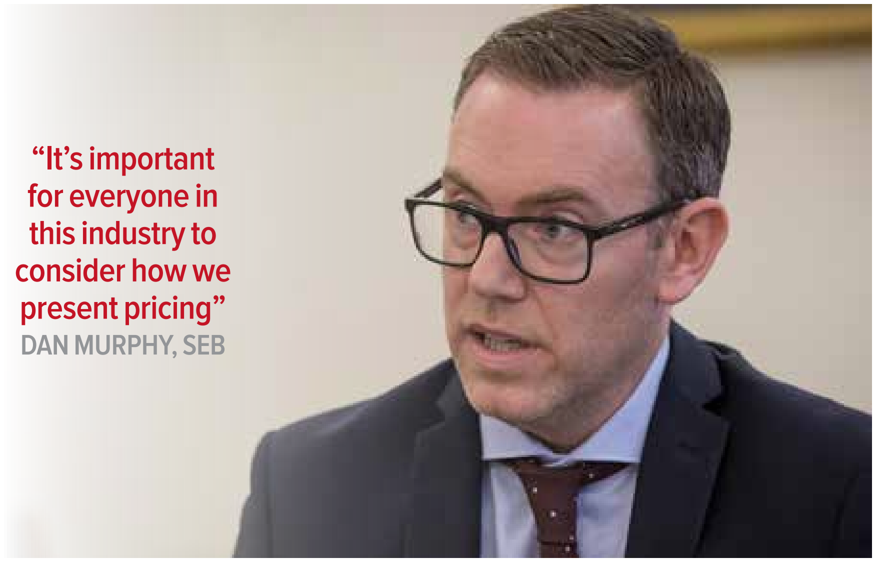
Allen: The search for alpha combined with a successful revenue year has brought new participants to the market. Those that have had a good year will be looking to do more with their programme in the future.

Kiely: We've been through a lot in 2016. A lower oil price has become the new normal. There was incredible equity market volatility in the first quarter and political shocks, such as Brexit, in the second quarter. For the short to medium term, interest rates are not going to go anywhere. And yet, despite all of the above, the securities finance market is still looking very healthy. We're seeing more business, especially from the Nordic region. Moreover, as the financial crisis of a few years' ago moves further away in the rear view mirror, people are gaining confidence. We can weather some of these market events because the right structure is in place in terms of risk management.

Strömberg: It's been a good year and volumes will keep going up. The focus is trying to add more IT aspects. There's a trend for people to focus on analysis and automation to get in the best position to service clients.

Mojanovski: The search for yield and collateral flexibility will continue and the securities finance industry is well positioned to meet those demands.

"The search for yield and collateral flexibility will continue and the securities finance industry is well positioned to meet those demands"
STEVCE MOJANOVSKI, DANSKE BANK



"It's important for everyone in this industry to consider how we present pricing"
DAN MURPHY, SEB

Brian Traquair, head of **FIS**' capital markets business, has announced his retirement. Toronto-based Traquair first joined SunGard in 2001 and became an executive vice president at the firm in 2014. FIS acquired SunGard last year. He focused on providing sell-side solutions across asset types for front, middle and back office needs of banks and broker-dealers. Risk and compliance, securities finance and post-trade derivatives are all areas of expertise for Traquair, who worked at Loanet from 1995 before it was bought by SunGard six years later. In total Traquair has spent 37 years in the financial services industry.


Brian Traquair

CODA Markets, an operator of a US equity trading platform, has made two new hires. **Pat Cestaro**, a 35-year securities lending veteran, is the firm's new chief sales officer and **Michael Lazar** has been named managing director of sales.Before joining CODA Cestaro was the chief executive and chairman of Quadriserv, prior to its recent sale to EquiLend. He spent 30 years as the head of securities lending and equity finance at JPMorgan and Bear Stearns, where he oversaw one of the largest securities lending programs in the industry. Michael Lazar has more than 25 years of experience in institutional sales roles, including 15 years at Liquidnet.

JP Morgan has named **Paul Brannan** and **Jonathan Cossey** as global co-heads of prime brokerage. Brannan previously served as the head of prime brokerage in the US and Cossey ran the division for Europe, the Middle East and Africa (EMEA). The promotions follow the recent appointments of Mark Leung and Jason Sippel as co-heads of JP Morgan's equities business globally. Other moves involve Luiz de Salvo and Dennis Fitzgerald, co-heads of cash equities trading in the Americas, who will take charge of the business globally.

Chicago-based **OCC** has added former Optiver US CFO **Amy Shelly** as senior vice president and CFO. Shelly replaces Kim McGarry and is now responsible for finance, accounting, strategic sourcing and facilities, as well as a new treasury function. **James Pribel**, formerly executive director and treasurer at CME Group, has also been named first vice president of treasury, which is a new position at OCC.

RBC has hired **Rebecca Bridgeman** from BNP Paribas Securities Services after six years on the French bank's securities financing desk. Bridgeman, who continues to be based in London, now serves as associate director of global client coverage at RBC. She previously held a front-office sales position as business development of securities financing.

Financial technology firm **CloudMargin** has made two new hires in the US. **Kari Litzmann** will become chief marketing officer, while **Martin Anderson** has been appointed senior sales executive, responsible for CloudMargin's overseas growth. Both will be based in CloudMargin's New York office. Litzmann joins CloudMargin with more than 12 years of experience leading branding, marketing and design projects as a consultant, entrepreneur and marketing strategist. Anderson joins CloudMargin from Thomson Reuters and brings 20 years of investment technology and sales experience.

Global Prime Partners (GPP), a provider of prime brokerage and trading services to hedge funds, asset managers and professional traders, has named **Mike Ward** to head new business development. In his new role, Mike will be initially tasked with expanding GPP's offering within the structured products, a division that was formed to create tailored capital market products for UK onshore clients, as well as new bespoke investment structures. Ward has over 20 years' experience in the industry. Most recently, he was co-head of EMEA equities at Nomura. Prior to that he spent eight years at Bank of America Merrill Lynch, where he was latterly head of EMEA equity sales.

Online brokerage **OANDA** has secured the services of **Neil McDonald**, who joins the company as its newest global head of trading and quantitative analytics. Neil is tasked with leading the company's strategic growth across electronic trading business with a special focus on the global trading, quantitative analytics and research groups. He previously worked for Prior to taking up financial technology firm Investment Technology Group. McDonald's career encompasses other senior roles including managing director and global head of electronic market-making and head of US derivatives trading for JP Morgan.

Credit Suisse has promoted **Indrajit Bardhan to become its new global** head of prime services. Bardhan, formerly global head of risk and head of Americas for prime services at the investment bank, takes on the position previously held by Michael Paliotta, who had the role alongside his duties as global

Claire Davis is leaving the International Securities Lending Association (ISLA). Davis, who was a relationship manager at the securities lending trade body, is joining **J.P. Morgan** according to reports. "We are obviously sorry to see Claire leave us and I would thank her for her contribution to ISLA and the industry during her time with us," said ISLA's chief executive Andy Dyson speaking to Global Investor/ISF. "We will of course be looking at various resourcing options as we consider any further recruitment following her departure.

CBOE hired an experienced futures and options sales trader in London to boost the US exchange operator's European sales effort. **Hemal Purohit**, a 20-year veteran, to work with Matt McFarland, the head of CBOE London who officially opened the Chicago group's first European office last month.

UAE looks to the futures

Nasdaq Dubai's equity futures market has introduced a new way of gaining exposure in the UAE, writes *James Gavin*

From a standing start on 1 September, the Gulf's first true futures market seems to have hit the ground running. Trading on Nasdaq Dubai's equity futures market increased rapidly in November as new investors entered the market. The 222,829 contracts traded during the month represented a more than doubling on the previous month, rising 116%.

Bourse chiefs will be cheered at this response. The rapid increase in trading on the Nasdaq Dubai since it opened its doors underlines both the novelty of these instruments, as well as investment managers' pressing need for broader palate of investment tools for both investment and wealth protection purposes.

"We need to have the tools to hedge, to be able to short-sell. If there's a drop in the market, I need to be able to use options and futures – the tools that institutional investors need to invest," says Ryan Lemand, managing director and head of asset management and wealth management at ADS Securities.

The Dubai equity futures market offers single stock futures contracts on nine leading UAE-listed companies: Abu Dhabi Commercial Bank, Aldar Properties, Arabtec Holding, DP World, Dubai Islamic Bank, DXB Entertainments, Emaar Properties, Etisalat and Union Properties. The market offers regional and international investors opportunities for hedging, leverage, and the ability to make gains when share prices are falling as well as rising.

Regional asset managers believe it marks a breakthrough for the wider region. Derivatives have been slow to take off partly because of cultural norms that view such products with suspicion.

"Nasdaq Dubai has introduced these tools which is a great step forward, and hopefully this will expand across the UAE and GCC. That should attract more institutional investors," says Lemand.

Expansion plans

The Dubai-based exchange plans to expand its range of futures in a phased programme, including contracts on companies listed on other MENA exchanges as well as index futures and equity options. It will also increase the range of connected brokers and other market participants. Currently, seven brokers are represented but this should increase as deeper understanding of futures permeates through the market.

The single stock future provides for an instrument to more accurately hedge exposures for asset managers and corporates. These will appreciate the ability to hedge existing equity position in the most attractive stocks such as Dubai real estate developer Emaar. This means they can insure against a price fall and will also have the ability to make money if they want to take a view on whether the market is up or down. Investors can gain from futures when the underlying share price falls, as well as when it rises. The futures are offered with 1-month, 2-month, and 3-month expiry dates in the currency of the underlying share listing.

The other major advantage is leverage. The impetus to pay the full cost of shares in Emaar, when the cost of buying Emaar futures is lower – and obtain all the upside – is a compelling prospect for many.

As Nasdaq Dubai CEO Hamed Ali pointed out: "Leverage on futures gives investors the possibility to make larger gains than if they had traded the underlying shares, and they can also use futures to protect their existing wealth."

Having whetted appetites, Nasdaq Dubai is now working to expand the range of derivatives through selected products with investor appeal. These could be futures on other GCC and MENA stocks, listed on other exchanges. The plan is to have trading options on indices too.

The broader strategic ambition is to spur others in the UAE to offer derivatives, and build critical mass for the asset class. So far it is slow going. Over the summer, Abu Dhabi-based asset manager, Akfar Capital, launched an ETF, but one that is physical, in-kind, rather than derivate-based. More work will be needed before ETFs bed into the Gulf's investment culture.

Nasdaq Dubai believes its first mover advantage will be significant, as will its links to the wider international investor community, something other local exchanges cannot offer. While the UAE's equity futures market is for now the preserve of local and regional investors, the likelihood is that larger asset managers will soon be looking more closely at Dubai's offering.

Kingdom kick-starts reform

A series of changes promise to transform Saudi Arabia into a formidable regional financial centre, writes *James Gavin*

This year Saudi Arabia cemented its evolution from tortoise to hare, with almost weekly announcements underscoring the seriousness of the government's intent to refashion the kingdom as global financial centre, diversified away from oil dependence.

Capital market reforms are central to the ambitious deputy crown prince Mohammed Bin Salman's vision. The Capital Market Authority (CMA) is looking to achieve MSCI Emerging Market status by as early as 2017.

That would help attract substantial volumes of new capital. The Tadawul intends to increase listings from 170 currently to 250 in the next seven years, adding at least $120bn to the current $400bn market capitalisation, following the anticipated initial public offering in state oil giant Saudi Aramco in 2018.

But the Saudis' opening to outside investors via the qualified foreign investor (QFI) regime has not yet elicited a rush of asset managers to its door. Figures from Jadwa Investment for the nine months between July 2015 – when the CMA first sanctioned plans to allow large foreign investors to gain exposure to Tadawul-listed securities – to March 2016 showed the net capital inflow from QFIs was just $211m, a minuscule 0.1% of total market cap.

Continuous improvement

This relative trickle has not put the Saudi authorities off from pushing ambitious changes. The tweaks to the QFI regime and other reforms suggest a quickening of the pace.

QFI rules were amended in May and again in August, lowering entrance barriers. Those wanting to participate need only have a minimum $1bn in AuM, compared to $5bn previously. The maximum holding of issued shares in a single listed company was doubled from 5% to 10%.

More change is in the pipeline, with new rules taking effect in January 2017 that allow QFIs to bid in the book-building process for IPOs. In November, the CMA approved rules allowing the formation of real estate investment trusts (REITs), giving investors easier access to local real estate.

"This will give the exchange new revenue streams with new traded instruments. It also hands investors more liquid instruments to play the real estate story, which resonates strongly in the Gulf," says a former Saudi investment banker.

Further ambition was signaled through a royal directive issued on 30 November, setting aside some $27bn (SR100bn) of funds from Saudi reserves for the Public Investment Fund (PIF). The PIF is to be transformed into a Qatari-style sovereign wealth fund (SWF), heralding the conservative kingdom's shift away from its risk-averse tradition of parking its cash reserves in US Treasuries.

> "Where there is reform, investors chase that reform and make money from it"
> ASHISH MARWAH, ADS SECURITIES

"MBS has hinted at a shift to a more aggressive investment style, and this is part of that process, making the PIF a formal SWF," says Jason Tuvey, an economist at Capital Economics.

Building volume

The PIF is expected to split its allocation between the local and international markets on a 50:50 basis, ensuring a domestic payoff for the Tadawul. All this should position Saudi Arabia as a more credible rival to more established Gulf financial centres such as the UAE, though it is a steep learning curve.

"It has taken the UAE 40 years with its diversification programme to get where it is now. For Saudi Arabia to achieve that is going to be hard. But what it can achieve is the liberalisation of the domestic market that would enable local businesses to prosper, before moving on to attracting foreign capital," says Ashish Marwah, senior director and lead investment manager at ADS Securities.

Asset managers stand to gain, especially those with a track record in the kingdom. "A lot of institutional investors are already in the Saudi market, trading under swap arrangements. That means there foreign investors aren't necessarily going to be putting in billions of dollars from zero. While a substantial amount of capital will come in, some of it will be transferable from current vehicles," says Mohamed Yasin, managing director of NBAD Securities.

There will also be spinoffs for the wider Gulf region. "The steps that the CMA has taken are all positive, and if Saudi Arabia makes it to MSCI EM status in a year or two that would be positive for the region as a whole. Where there is reform, investors chase that reform and make money from it," says ADS's Marwah.

Emerging obligations

MEIRA's *Alex MacDonald Vitale* says that the shift to emerging market status means the Middle East needs stronger standards of access, transparency and proactive disclosure

In recent years we have seen the Middle East and North African (MENA) region weather a number of significant challenges; from the global economic downturn leading to foreign direct investment (FDI) vanishing overnight, to the complexities of the Arab Spring and oil prices falling to their lowest levels in over a decade.

It is testament to the region's resilience that despite these setbacks and continued uncertainty, MENA economies continue to forge ahead. Albeit at a slightly diminished pace given the fiscal shortfall, the GCC in particular is maintaining its commitment to the core infrastructure projects required to sustain its shifting demographics, where around 60% of the population is under the age of 25.

Given the rapid rate of development underway it is easy to forget that these are still frontier-to-emerging markets, and while it is true to say the economies of the MENA region continue to progress at varying speeds, one consistent theme emerges – they have made tremendous strides in a very short period of time.

International standards

The most prominent centres have moved from theoretical aspirations to practical application of increasingly international standards, with the UAE and Qatar acceding to MSCI and FTSE Emerging Market status in 2015 and Saudi Arabia expecting to be reclassified by 2018.

Even the smaller centres have kept pace, with Kuwait relaunching an entirely new Bourse, Oman updating its corporate governance legislation and Bahrain adjusting its capabilities as a financial hub.

Markets across the Levant and North Africa continue to maintain strong connectivity with international counterparts and exceptional examples such as the Palestine Exchange stand out as a model for dynamic investor engagement.

In many respects there is still a long way to go for these markets to achieve the momentum needed to secure upper-emerging classification and gain access to the broader capital flows that they aspire to, but recent efforts prove intent and determination.

Of particular note are some of the more innovative solutions created to make regional markets more attractive to the international professional investor network.

From 2016 new regulations in the UAE made it mandatory for listed companies to establish an investor relations function and develop proactive communications with the market. Qatar is exploring similar solutions, while Saudi Arabia's market authorities have launched a combination of revised corporate governance standards and a Qualified Foreign Investor scheme to provide direct access to the Tadawul.

While still relatively untested, these are important steps that signal real intent to establish the market infrastructure needed to satisfy the requirements of both retail and institutional investors.

Now is not the time for complacency. The international indices demand high standards of transparency and engagement, especially given the massive increase in regulations and scrutiny in developed markets. Moving from frontier to emerging status requires real commitment, but the story only starts there.

In order to retain these classifications, more work is needed to develop a predictable culture of open accountability and access, building trust over time. This is especially true where aspirations lead to bids for developed status.

Research had shown that while a number of influential investors had enthusiastically allocated to frontier and emerging regions following a successful first meeting with investor relations and C-suite executives of target firms, they have often been unable to remain invested due to lack of continuity.

For an institutional investor, the initial meeting with executive management is just the beginning of a long-term process in building trust and conviction. If senior representatives fail to engage in follow-up due diligence meetings, professional investors lack the crucial elements needed to retain their positions.

Furthermore, the international perspective suggests that while market infrastructure and regulations have significantly improved, enforcement still seems to be a challenge for some markets. So while the mechanics are there, we need to see delivery of the international standards professional investors expect.

One of the tools used to deliver this is the role of investor relations. While the function is still maturing, access, transparency and proactive disclosure remain universal standards of best practice. These principles are the foundation for successful C-suite engagement with investors, and complimentary efforts of other key functions within listed firms.

Alex MacDonald Vitale is the chairman of the Middle East Investor Relations Association

MENA leaders

Global Investor/ISF recognised the individuals and businesses that contributed the most to the Middle East and North African capital markets at a gala ceremony in Dubai on 26 October

REGIONAL AWARDS

CEO of the year: **Jassim Alseddiqi**
The ADFG head has steered a sizeable increase in AuM at the Abu Dhabi-based group

Asset manager: **NBAD Global Asset Management**
An innovative approach to asset management, tapping into the strength of its brand and network

International Asset Manager: **ADS Securities Asset Management**
Robust growth in clients and AuM since launching just two years ago

Equities Manager: **NBK Capital**
A seasoned investment team is geared to ensuring products meet clients' shifting requirements

Fixed Income Manager: **Emirates NBD Asset Management**
The UAE giant deploys sophisticated techniques to drive performance and control risk

Sharia Fund Manager: **UNB**
The Abu Dhabi-headquartered bank has achieved positive Alpha from its Islamic funds

Sukuk Manager: **Abu Dhabi Islamic Bank**
A strong track record in innovation in Islamic debt capital markets

Wealth Manager: **Barclays**
Technology and innovation are central to its success in the MENA region

Cash Manager: **Arab Bank**
Has reaped the rewards of cash management systems engineered specifically for the MENA region

Infrastructure Manager: **The Investor for Securities Company**
Infrastructure development funds form part of the Saudi company's broad offering

Real Estate Investment Firm: **Abu Dhabi Financial Group**
With a high-end property portfolio, the group has shown strong growth is still possible

Global Custodian: **Citibank**
Committed significant resources, exemplified by the development of its Middle East global custody

Sub-custodian: **Standard Chartered**
Strong relationships and a new integrated custody platform have resulted in growth

Fund Administrator: **HSBC Securities Services (HSS)**
HSS supports clients with their fund administration needs in challenging circumstances

Transition Manager: **CitiTM**
Strong global coverage and local presence has enabled robust growth in the region

Financial Centre: **Abu Dhabi Global Market**
The world's youngest financial centre is looking to establish itself as a fintech specialist

Exchange: **Dubai Gold and Commodity Exchange (DGCX)**
The DGCX has cemented its reputation as a bridge to the emerging markets

Broker: **Morgan Stanley Saudi Arabia**
After almost a decade in Saudi Arabia it remains at the forefront of innovation in equities

Forex Broker: **ADS Securities**
The Abu Dhabi firm has become a centre for FX trading by investing in cutting edge trading solutions

Alternative Asset Manager: **Sidra Capital**
Robust increases in revenues and AuM attest to a strong investment philosophy

Best Newcomer: **Aventicum Capital**
The Qatar Holding-Credit Suisse joint venture has made an immediate impact

Law Firm: **Arendt & Medernach**
The firm has a broad presence and the largest funds team advising on Luxembourg law

Consultancy Firm: **Insight Discovery**
Provides consultancy work and research including the Middle East Investment Panorama report

ASSET MANAGER – COUNTRY AWARDS

Egypt: **CI Capital**
CI Asset Management is a pioneer in Egypt, bringing in innovative products to an evolving market

Jordan: **AB Invest**
The kingdom's largest asset manager demonstrated robust growth in a volatile climate

Kuwait: **KAMCO**
Its prudent investment philosophy commands the goodwill of a large client base

Lebanon: **Blominvest**
The Beirut-based firm has created steady growth, emerging as a significance regional player

Morocco: **Wafa Gestion**
The kingdom's largest asset manager has reaped the rewards from fostering innovation

Oman: **Bank Muscat**
The sultanate's largest fund manager has created consistent performance in its portfolios

Qatar: **QNB**
With an AuM of $5bn, QNB has been able to outperform all its markets

Saudi Arabia: **Sedco Capital**
It achieved success managing high quality real estate assets via direct investments

UAE: **Rasmala Investment Bank**
A contrarian innovator in the investment management space

BROKER – COUNTRY AWARDS

Egypt: **EFG Hermes**
The Egyptian giant has had an active year, with some heavyweight IPO listings

Jordan: **AB Invest**
The Amman-based brokerage is committed to high levels of transparency and disclosure

Kuwait: **EFG Hermes**
EFG Hermes has sought to raise the bar among Kuwaiti brokerage houses

Lebanon: **MedSecurities Investment**
The Beirut-based broker is an innovator and leader in complex transactions

Oman: **EFG Hermes Oman**
EFG Hermes' Muscat operation has captured a significant slice of foreign investor flows

Palestine: **Al Wasata Securities**
Still leading the field in its home market

Qatar: **QNB FS**
Positioning itself as a key player in developing the Qatari market

Saudi Arabia: **Al Rajhi Capital**
The first to obtain Saudi authorisation with advanced global execution systems

UAE: **NBAD Securities**
The Abu Dhabi-based brokerage has a strong research offering that enables a breadth of coverage

Making markets

Low oil prices have put pressure on MENA economies but, combined with demands of international investors, have also triggered widespread market reform. James Gavin reports from the *Global Investor/ISF* MENA Capital Markets Summit 2016

Capital markets across the MENA region are undergoing a period of rapid reform, from the creation of liquid bond markets in the UAE and the internationalisation of Saudi Arabia to the formation of a fintech ecosystem in Abu Dhabi.

The seventh *Global Investor/ISF* Summit, which took place in Dubai on 26 September, brought together leading industry figures to discuss the issues shaping the market. What follows are the highlights of the discussions that took place.

GCC bond market boom

Bond markets across the Gulf Cooperation Council (GCC) are undergoing rapid development, in terms of both sovereign and corporate issuance.

The emergence of a stronger regional fixed income market provides a concrete example of how the lower oil price, which halved during the second half 2014 from above $100 and has remained low and volatile since, has spurred market reform.

Ashish Marwah, senior director – lead investment manager at ADS Securities in the UAE, said that Gulf countries are now looking to build yield curves to provide a basis for corporates to price issuance, citing Saudi Arabia's launch of a $17.5bn sovereign bond.

"Look at how strong the demand is for Saudi bonds among both primary and secondary investors," he said. "This is increasing liquidity in the market and increasing the participation of foreign investors, which creates a two-way market that is beneficial for all investors."

One factor that is attracting interest in MENA bond markets is the contrast with developed markets where the most credit-worthy nations enjoy negative yields, said Saleem Khokhar, executive director and head of fund management at NBAD in the UAE.

Khokhar points out that the region also has favourable fundamentals in absolute terms. "When you look at the GCC region, you see good reserves, low debt-to-GDP ratios and strong government backing for a number of the government-related entities (GREs) and corporates.

CEO of the year Jassim Alseddiqi speaks at the summit

"So, thinking beyond government bond issues, when our companies go to the market and raise debt – as they will in the near future – you have quite a strong case for a solid issue, plus decent yield coming to the market. That is all positive."

However, the boost to the bond markets didn't mean that an imminent pickup in moribund initial public offering (IPO) activity was also likely, he added.

"There won't be a general pickup in listings, but specific assets will come through from the public sector, such as the Saudi Aramco IPO, and there are plenty of assets that could come through on the UAE side of the equation as well," he added.

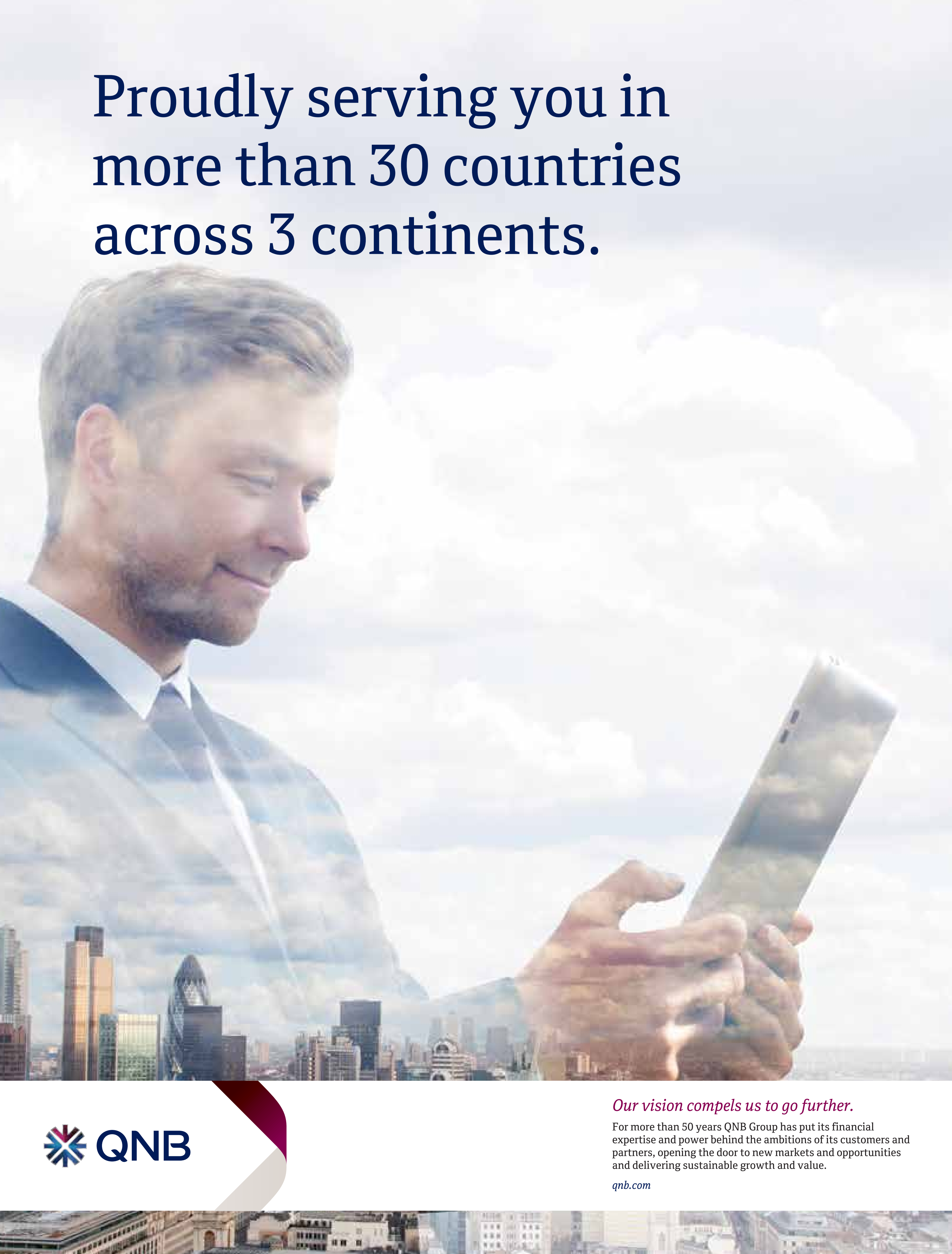
Push for international standards

The increasing number of international investors moving into MENA markets has led to demands for changes in custody and settlement arrangements to ones closer to international standards. New regulations across the region have sought to bolster regional exchanges to meet these demands.

"We see things such as short selling being talked about more actively, and we may see this speed up in 2017," according to Mohamed Yasin, managing director at NBAD Securities.

There has also been significant movement in terms of investment products being offered. "We've also seen things this year such as an ETF being introduced on the Abu Dhabi Global Market (ADGM) and futures being introduced on Nasdaq Dubai, reigniting activity last seen before 2008-09. All these things are positive for us."

Robert Ansari, executive director


Proudly serving you in more than 30 countries across 3 continents.
QNB
Our vision compels us to go further.
For more than 50 years QNB Group has put its financial expertise and power behind the ambitions of its customers and partners, opening the door to new markets and opportunities and delivering sustainable growth and value.
qnb.com

at index compiler MSCI, agreed that demand for evolution in capital markets is in part driven by the needs of foreign investors. "The demand that MSCI is hearing about from its clients is largely driven by what is happening in Saudi Arabia."

According to Ansari, regulation in the region is evolving to capture the protection of local investors as well as seeking to attract international investors. "They are thinking about regulation to provide a framework for foreign investment," he said.

Muneer Khan, a UAE-based partners at international law firm Simmons & Simmons, noted the important jurisdictional challenges that need to be addressed between the varying regulatory frameworks, such as ones within the UAE.

"We often get asked by international investors, asset managers and financial institutions looking at greater involvement in the region how the different jurisdictions fit together, and about the interplay between regulatory regimes.

"We see increased dialogue between regional regulators. We're still some way from a passporting regime, but one of the interesting and unusual factors is that some of the newer regulators and authorities – such as those in the DIFC and the ADGM – are pushing that agenda and acting as advocates for the industry," said Khan.

Investor relations

New regulations in the UAE have made it mandatory for listed companies to establish an investor relations (IR) function and develop proactive communications with the market.

Alex MacDonald-Vitale, chairman of the Middle East Investor Relations Association, said that while infrastructure and regulation have significantly improved in recent years, enforcement remains a challenge.

"We need to establish a consistent standard, with board directors and senior executives leading the cultural shift to greater openness and accountability – precisely the effort that the IR role is designed to support. The mechanics are there, now we just need to see delivery of the international standards professional investors expect."

The IR function is still maturing, said MacDonald-Vitale, with access, transparency and proactive disclosure bywords of best practice. "These principles are the foundation for successful C-suite engagement with investors, but it has to become an ongoing effort."

Research had shown that while a number of influential investors had come in to the region with enthusiasm following a successful first meeting with IR representatives and the C-suite, they were unable to remain due to lack of continuity.

"For an institutional investor, the initial meeting with executive management is just the beginning of a long-term process in building trust and conviction. If senior representatives fail to engage for follow-up due diligence meetings, professional investors lack the crucial elements needed to retain their positions," said MacDonald-Vitale.

Saudi transformation

The much-anticipated liberalising reforms in Saudi Arabia, set out in its Vision 2030 reform blueprint, will be far-reaching and some of its effects are already being felt.

Ryan Lemand, managing director and head of asset management and wealth management at ADS Securities, highlighted the "transformational" nature of the changes taking place in Saudi Arabia: "Actions taken by policymakers in Saudi Arabia, such as opening up capital markets, are moving things forward slowly but surely."

While some investors took the recent news that government ministers' salaries are being cut as a sign of financial troubles, Lemand argued the opposite: "The message is that they are reforming from the top down."

Lemand noted that many other changes in Saudi Arabia that were taking place below the radar, such as the recent move from the Hijri calendar to the Gregorian calendar. He said it was a huge change for a conservative country such as Saudi: "It is all part of the message that it is reaching out to global investors."

Fintech ecosystem

Fintech has become established as core focus for the Abu Dhabi Global Market (ADGM), with plans to establish the pre-eminent ecosystem in the region.

The executive director of capital markets at the ADGM's Financial Services Regulatory Authority, Wai Lum Kwok, said that ADGM has taken a proactive, top-down approach to foster and support a fintech ecosystem for the MENA region.

"We have been actively developing the ecosystem and bringing key fintech stakeholders together. Among the initiatives we have introduced include the Regulatory Laboratory that allows fintech players to experiment and develop their innovative solutions in a safe and controlled environment without being subject to full authorisation requirements."

The importance of an ecosystem goes beyond fintech itself as it informs the way that banks and financial services firms think about the region, said Dima Jardaneh, executive director and head of economic research for MENA at Standard Chartered.

"The region's ecosystem was very much centralised around oil revenues, but now governments want to reach out to the private sector and broaden the sources of funding."

Dubai data

The volume of OTC transaction data emanating in or from the Dubai International Financial Centre (DIFC) is expanding at rapid pace, according to Brad Douglas, director of markets at the DFSA.

"Provisional data highlights that the amount and significance of OTC fixed income transaction activity emanating in or from the DIFC has increased significantly in recent years.

"In the 12 months to 2015, the amount of OTC fixed income transaction activity was $1.3trn. For the six months to June 2016 the level of OTC fixed income transaction activity has doubled to $1.2trn, projected to be above $2trn for the year of 2016."

Lombard Risk Management has reinforced its product and sales teams in the Asia Pacific with three new hires. **Nimoh Mohankumar** and **Nathan Li** will contribute to the growth of Lombard Risk's market share in the region. Mohankumar, previously of Broadridge's Southeast and North Asia desk, was appointed as senior sales executive. Li joins as sales executive from FIS, where he was responsible for the North Asia market. In the product team, **Jonathan Tsang** joins as senior product consultant for regulation in Asia. He will provide pre-sales consultancy, implementation and support services to Lombard Risk's clients including banks, hedge funds, fund administrators and asset managers.

Jonathan Hausman has been promoted to lead the new global strategic relationship department at the **Ontario Teachers' Pension Plan**, which is responsible for developing beneficial investment relationships around the world. Hausman will lead the pension fund's

investment missions to new markets and has led the investment division's emerging markets committee for several years.

Prudential's asset management business in Asia, **Eastspring Investments**, has appointed industry veteran **Virginie Maisonneuve** to the role of chief investment officer. Her new role will commence on January. She will be responsible for managing all investments at the firm, including the firm's equity, fixed income, asset allocation, private equity, infrastructure and onshore investment offerings.

The board of **J.P. Morgan Emerging Markets Investment Trust** had appointed **Ruary Neill** as a Non-Executive Director of the Company. Neill worked in investment banking for 28 years where he most recently managed the multi asset sales business at UBS Investment Bank. This entailed working closely with chief investment officers and senior asset managers on strategic and tactical asset allocation decisions. Prior to this he spent a number of years working in the Asian equity markets for UBS Investment Bank

Asian and emerging market specialist **Fullerton Fund Management**, a wholly-owned subsidiary of Temasek Holdings, has announced the appointment of a new CIO based in Singapore. **Patrick Yeo** who is currently head of fixed income at the firm will now take on the role of chief investment officer. Yeo will oversee the investment direction and strategy of all asset classes and investment portfolios at Fullerton. Additionally, he will continue with his fixed income portfolio management responsibilities.

Old Mutual Emerging Markets (OMEM) has appointed **Iain Williamson**, currently OMEM Finance Director, as interim chief executive officer. Williamson will take on his expanded role on January 2017 and will remain in post until a permanent candidate for the CEO role is found. Williamson joined Old Mutual in 1993 and has held a number of senior leadership positions including managing director of Old Mutual South Africa's largest operating unit, the Retail Affluent segment.

The Abraaj Group, an investment group focusing on growth markets, has appointed **Mark Bourgeois** as partner, global head of investor engagement and chief executive of Abraaj North America. He joins Abraaj from Atlantic-Pacific Capital where he most recently served as President and CEO. Prior to joining Atlantic-Pacific, he was the global head of distribution and the chief executive of the Americas for Credit Suisse Asset Management. He has also held senior leadership roles in Lehman Brothers and UBS Private Funds Group.

Quantum Global Group, an investment firm focusing on Africa, has added **Cheick Diarra** and Dr. **Thomas Ladner** to its advisory board. The board is made up of international experts tasked with helping the group build strategic alliances with key African stakeholders including governance institutions, research and specialist establishments.

Schroders has appointed **Sok Mun Wong** as head of fixed income and foreign exchange trading for Asia. Wong will be based in Singapore, Schroders' central trading hub in Asia. Wong joins Schroders from Tudor Capital, Singapore where she was trader – head of Singapore execution team for the past two years. Prior experience includes The Rohatyn Group (TRG), ABN Amro Private Bank and Black River Asset Management.

GFH, the Bahrain based financial group, today announced the appointment of **Hammad Younas** as head of investment management. Younas will manage the overall investment business of the bank including asset management, private equity and corporate investments. He most spent 13 years at EY, where he served as chief executive of Ernst & Young Corporate Finance in Bahrain.

Mirae Asset Global Investments, one of the world's largest investors in emerging market equities, has announced that **Peter Lee** is stepping into the role of CEO and chief investment officer. Previously, Lee had been the executive managing director of the global investment unit for Mirae Asset Global Investments in Seoul, South Korea, leading the equity investment team from the group's global headquarters.

PineBridge Investments has appointed **Jennifer Theunissen** to a new role as chief operating officer for Asia. Theunissen will play a central role in co-ordinating compliance, finance, operations, product management and development, and technology functions across the region. She is based in Hong Kong and will report to global chief operating officer, Julian Sluyters and Asia chief executive officer, Rajeev Mittal. PineBridge is continuing to grow its team and operations in the Asia Pacific region, particularly in the institutional space.