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ASIA 2023

Welcome to the Securities Finance Times Asia Annual 2023

The challenges of managing economic and political uncertainty feature as a repeating theme across the contributions published in this volume. The turmoil generated by the pandemic has given way to geopolitical worries linked to Russia's military action in Ukraine.

Overarching this background, collateral specialists reflect on how securities finance markets will react to central bank moves towards monetary normalisation, as an extended period of low interest rates gives way to double-digit inflation, interest rates approaching four per cent in many major markets and indications that central banks will step up the unwind of their asset purchase programmes over the coming 12 months.

While 2022 has been a challenging year for Asia's securities lending markets, regional specialists find reasons to be positive with APAC equity lending portfolios overcoming macro headwinds to modestly exceed expectations.

Australia's securities lending market performed strongly, boosted by BHP Group's corporate unification, and lending revenues in Taiwan benefited from a surge in short exposure to its technology-dominated index. In contrast, the traditionally strong lending revenues from Japan and Hong Kong suffered in the face of a relative lack of event-driven activity.

Contributors report a healthy pipeline of new business opportunities in the APAC region as existing securities lending markets strive to become more efficient and nascent markets find their feet. Securities lending specialists are monitoring capital market reform in China with expectant interest, although the operating models offered through Stock Connect or QFII still present idiosyncratic challenges. In Indonesia, PASLA has been working with market authorities to open up the market and to promote international standard market practices.

With the US preparing for T+1 settlement in 2024, eyes have turned to South Asia over the past 12 months to gauge how India's transition to T+1 will impact post-trade efficiency and the delivery of securities services. Having conducted a phased implementation since April 2022, starting with relatively illiquid names and moving to blue chips, India transitioned to next-day settlement in the equity cash segment on 27 January 2023.

Collateral automation and optimisation remain dominant themes in APAC, as they do globally, as firms look beyond compliance to assess the efficiency and cost of their securities financing transactions and the impact on balance sheet.

Contributors highlight how, during the pandemic, collateralised lending markets performed an essential role in mitigating credit and liquidity risk. However, this experience reinforced the need for automation across the transaction lifecycle, including collateral transfers and settlement. As trade volumes spiked and margin calls proliferated, a number of firms experienced vulnerabilities because they lacked automated processes to support collateral movements — a trend which recurred in September 2022 when gilts yields rose sharply following the UK mini-budget.

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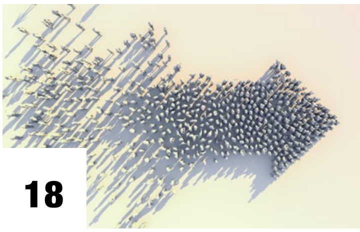


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Zodia Custody and SBI to establish crypto asset venture in Japan

Crypto asset servicing provider Zodia Custody and SBI Digital Asset Holdings (SBI DAH) are to launch a joint venture in Japan.

The joint venture will act as a Japan-based crypto assets custodian, targeting institutional clients.

The venture will allow both groups to expand their existing markets presence and increase their ability to provide custody services and other ancillary services for crypto assets to institutional clients.

SBI and Zodia Custody will use their technical expertise in the crypto asset space as well as their operational knowledge to ensure the appropriate safeguarding of the institutional client's assets.

51 per cent of the venture will be owned by SBI DAH and 49 per cent by Zodia Custody.

Zodia Custody is a subsidy of Standard Chartered and is also backed by Northern Trust.

Julian Sawyer, CEO of Zodia Custody, says: "Partnering with SBI DAH ensures the joint venture will offer gold-standard crypto asset custody services in Japan. Zodia Custody is both proud and excited to be working with SBI DAH to help set up SBI Zodia Custody — the first Tier 1 crypto asset custodian for institutions in Japan."

Fernando Luis Vazquez Cao, CEO of SBI DAH, adds: "We believe our partnership with Zodia is a unique global proposition to institutional clients, supporting our vision to become a pioneer and global trusted partner in the financial industry. We are excited about the path ahead of us."

Standard Chartered approved for 'wholly foreign owned' securities firm in Beijing

Standard Chartered Bank (Hong Kong) Limited has been granted in-principle approval by the China Securities Regulatory Commission (CSRC) to set up a securities firm in Mainland China.

With an initial capital injection of RMB 1.05 billion (US$155.6 million), the new firm, Standard Chartered Securities (China) Limited, will cover underwriting, asset management — restricted to asset-backed securities only — own-account trading and brokerage activities.

The move is set to play a key role in Standard Chartered Group's business strategy in China. Based in Beijing, the new firm will provide products and services related to China's onshore capital markets for onshore and offshore clients.

Standard Chartered says this is the first time the CSRC has granted in-principle approval for the set-up of a securities firm wholly owned by a foreign shareholder via greenfield investment in its onshore market, since the lifting of ownership restrictions for foreign financial institutions in 2020.

The bank will appoint John Tan, head of financial markets, Asia at Standard Chartered, as chairman-designate of the new securities firm, and Grace Geng as CEO-designate.

In February 2022, Standard Chartered announced that it will invest US$300 million in China-related businesses over the next three years, aiming to help clients capture opportunities brought by China's continuous opening up.

Commenting on the milestone, CEO of Asia, Standard Chartered Benjamin Hung says: "We are confident of the continued opening of financial markets in China and are very positive about the country's development prospects.

"In particular, the promising investment value of the onshore capital markets and the growing attractiveness of Renminbi assets in offshore markets. This is another major milestone for our China franchise, one we remain very committed to."

Jerry Zhang, executive vice chairman and CEO of China, and Cluster CEO (China and Japan), Standard Chartered, adds: "As China continues to open up its capital markets rapidly, the importance of Chinese assets in the global markets keeps growing, while the efficiency of its resource allocation is also improving.

"With the official approval granted, we expect that when the securities firm launches its business, Standard Chartered will be able to better serve our Chinese and overseas clients, providing holistic and high-quality financial services, including in exchange markets to both mainland and international enterprises and institutions 'going in' and 'going out' of China's markets."

Geng says the firm will have a unique business strategy and focus on fixed-income businesses. She continues: "Riding on the bank's international network, strong capacity in product innovation and structuring in the fixed income area, as well as its full commitment to serving China's capital markets, the securities firm will adopt a differentiated business model."

BNY Mellon launches Korea pledge model

BNY Mellon has gone live with its enhanced Korea pledge product on the firm's International Collateral Management platform.

With the enhanced Korea pledge model in triparty, the firm says that equities and Korean treasury bonds (KTB) can be utilised more efficiently as collateral.

This can be done under BNY Mellon's standard pledge arrangements with real-time security interest pledge marking.

BNY Mellon indicates that with a recent amendment introducing tax exemption on KTBs in South Korea, the asset becomes more appealing to support a firm's collateral obligations.

CEO of clearance and collateral management at BNY Mellon Brian Ruane says: "We are delighted to announce that the enhanced Korea pledge product is now live on our International Collateral Management platform."

APAC attains US$310.9 billion in outstanding repo value, says ICMA

The Asia-Pacific non-Japan region has attained US$310.9 billion in the outstanding value of repo and reverse repos, a 19.5 per cent rise YoY. Average daily turnover has risen 48.3 per cent YoY to US$43 billion, according to the Asia-Pacific repo market survey conducted on 8 June 2022.

The report was conducted by the International Capital Market Association (ICMA) European Repo and Collateral Council (ERCC) and Asia Securities Industry and Financial Markets Association (ASIFMA).

The survey found a distinct change in the geographical nature of business, with a decline in cross-border business between APAC and Europe, relative to cross border business within APAC.

This theme was also reflected in major shifts away from transactions with counterparties in Europe, the US and major Asian markets in favour of "other APAC" and Australian counterparties.

Repo trades collateralised by European securities and US Treasuries lost ground in favour of Japanese securities and international bonds (eurobonds), ICMA reports. However, both US Treasuries remain a "significant source" of collateral. Overall,

government securities became the largest class of collateral.

The paper highlights that the bulk of business in the non-Japan repo market share of reported repos was still executed directly between parties by telephone and electronic messaging. However, voice-brokers and, to a lesser extent, automatic electronic trading systems, increased their share over the period under review. Additionally, there was a rise in the share of repo trades cleared through a central counterparty.

In terms of currency, the US dollar remained dominant in the APAC (non-Japan) repo business. However, the percentage of repo trades used to raise funding in Japanese Yen rose over the period, largely at the expense of the euro, with AUD repo also remaining a significant component of overall repo activity for the region.

Philippe Dirckx, managing director and head of fixed income at ASIFMA, says: “The ASIFMA and ICMA survey shows the growing importance of repo across the region and the dynamics of its structure and stakeholders.

“It is encouraging to see the regulatory changes supporting its development aligned with our members’ expectations and requirements. There nevertheless remain impediments limiting cross-border repo to fully leverage the liquidity of the on-shore market.

DBS becomes first bank in Asia to complete an intraday repurchase via blockchain network

DBS has become the first bank in Asia to complete an intraday repurchase (repo) transaction on J.P. Morgan’s intraday repurchase application via Onyx Digital Assets (Onyx).

Onyx is a blockchain based network which supports instant settlements and maturity of the transactions within hours, instead of the current industry norm of one to two working days.

The news comes a month after DBS Bank joined LCH SwapClear as the clearing service’s first direct member in Singapore.

Commenting on the recent transaction, Andrew Ng, head of treasury and markets at DBS, says: “Repurchase agreements or repos are a traditional and well-established method of raising financing, but infrastructural and technical inefficiencies mean the minimum term has usually been one day.

“In the past, banks around the world had to explore alternative routes for intraday financing requirements. Through leveraging efficiencies of a blockchain-based solution, we are able to raise USD funding in compressed time frames which are beneficial to our liquidity needs.”

Ed Bond, head of trading services APAC at J.P. Morgan, comments: “This is the first time that J.P. Morgan is acting as both triparty agent and collateral token agent, which is an exciting development for the market. DBS has been a great partner on this project and we will continue looking at ways to innovate and help our clients navigate market challenges.”

"This is one of the key areas of focus when we engage with the relevant regulators and market infrastructures."

BOJ implements relaxed measures for securities lending facility

The Bank of Japan (BOJ) has relaxed the terms applicable to its securities lending facility for 10-year Japanese government bonds (JGBs), enabling it to lend bonds purchased through its asset purchase programmes back into the market.

The move aims to ensure stability in the market by easing excessive tightening in the supply and demand of Japanese government securities in the repo market, enabling the central bank to offset potential concerns around collateral shortages and to manage market liquidity.

The BOJ continues to purchase cheapest-to-deliver bonds under the relaxed conditions, which came into effect on 30 November 2022. Under the relaxed terms, the Bank of Japan has extended the maximum number of consecutive days for purchases of a specified security from 50 to 80 days.

Prior to the relaxation, lending was permitted for cheapest-to-deliver issues where the BoJ's holdings in the market exceeded 80 per cent. From 30 November 2022, this restriction was lifted to embrace all cheapest-to-deliver issues, regardless of the Bank's holdings in the security.

ESMA grants third-country CCP recognition to Bursa Malaysia Derivatives Clearing

Bursa Malaysia Derivatives Clearing has been recognised by the European Securities and Markets Authority (ESMA) as a Third-Country CCP (TC-CCP), according to a statement from its parent company, Bursa Malaysia Derivatives Berhad.

Under the European Market Infrastructure Regulation (EMIR), only approved TC-CCPs are permitted to provide clearing services to clearing members or trading venues established in the EU.

With this TC-CCP recognition, market participants clearing derivatives trades through Bursa Malaysia Derivatives will be subject to lower capital charges under the Basel III framework.

Bursa Malaysia Derivatives Berhad explains that with TC-CCP recognition granted to its derivatives clearing arm, the exchange will now have improved access to Europe's investment communities, while European counterparties will find it more straightforward and cost-efficient to trade and clear through the Kuala Lumpur-based exchange group.

Bursa Malaysia Derivatives acting director Mohammed Saleem Kader Bakas says that this recognition confirms that Bursa Malaysia is aligned with international standards and that this will generate new opportunities to do business with European clearing institutions.

"We are the third Exchange in the ASEAN region to be accorded this recognition, which is a significant milestone for Bursa Malaysia," he adds.

Beijing Stock Exchange announces rulebook for securities lending and margin trading

The Beijing Stock Exchange has announced a rules framework for securities lending and margin trading in advance of its proposed launch of trading services in these areas.

In an announcement made through Chinese official press agency Xinhua, the Beijing exchange indicates that these rules will align with those established on the Shanghai (SSE) and Shenzhen (SZSE) stock exchanges, which have already launched securities lending and margin trading services.

According to the Beijing exchange, this development will help to strengthen the pricing function of the market, improve margin liquidity and cater for the diversified trading demand of investors.

Reflecting on its wider listings activity, the Beijing Stock Exchange indicates that 110 companies had listed on the exchange at the start of September, with combined market capitalisation of close to CNY 200 billion (US$28 billion).

Last month, the Shanghai and Shenzhen exchanges extended the range of shares eligible for securities lending and margin financing. SSE added a further 200 names to its list of eligible stocks, bringing this to a total 1000 stocks. SZSE added a further 400 shares, establishing a list of 1200 stocks that are eligible for securities lending and margin trading.

BNY Mellon expand collateral management platform

BNY Mellon has expanded its International Collateral Management platform, adding support for Indonesia to its existing network.

The expansion is part of BNY Mellon's planned growth in the APAC region, with solutions to be developed in Malaysia and Taiwan.

Collateral management supports risk management for secured financing transactions, allowing assets to be used for collateral purposes.

The development follows BNY Mellon's launch of its new User Interface earlier this year, which allows clients to view their total collateral sources and uses, while accessing all solutions in a single ecosystem.

Brian Ruane, CEO of BNY Mellon Government Securities Services Corporation and Clearance & Collateral Management, says: "This is an example of BNY Mellon's strategy of connecting to new markets and new central counterparties, allowing our clients to mobilise collateral across our global platform."

CFETS and Clearstream trade first triparty repo on ESG bonds in China

The China Foreign Exchange Trading System (CFETS) and global post-trade provider Clearstream have entered into an infrastructure cooperation to support triparty repo using ESG-compliant bonds.

The move enables Chinese market participants to trade environmental, social and governance (ESG) eligible triparty repo. The repo trades are executed on CFETS' bond and FX trading platform on the Chinese mainland, with Clearstream serving as triparty repo agent and supporting associated collateral management, settlement and custody requirements.

The first set of triparty repo transactions were conducted by China Construction Bank, China Merchants Bank, Crédit Agricole CIB, Industrial and Commercial Bank of China and Shanghai Pudong Development Bank.

All participants selected eligible ESG bonds based on dedicated baskets provided by Clearstream.

The infrastructure cooperation aligns with Clearstream's goal to support investors that are seeking to include ESG aspects in their investment decisions, according to Philip Brown, CEO of Clearstream Banking S.A.

Commenting on the news, Jiawen Peng, general manager of asset and liabilities management department at China Merchants Bank, says: "Repurchase transactions are an important financing tool in the interbank foreign exchange market.

"These triparty repo trades on ESG eligible foreign currency bonds are the result of joint efforts made by domestic and foreign institutions to promote the development of FX market infrastructure, which will further promote the development of green finance."

Taiwan again tightens short-selling

Taiwan's financial authorities reinforced short-selling restrictions on 21 October 2022, following on the back of similar action in the Taiwanese market taken on 3 October 2022.

According to new rules applied by Taiwan's Financial Supervisory Commission (FSC), restrictions will apply to short sales of an equity security if its share price has fallen by 3.5 per cent or more from its closing price from the previous trading session.

In these circumstances, investors will be prohibited from using the previous closing price, or a lower price, to short the stock through borrowing securities, according to a statement released by the FSC through Taiwan's Central News Agency (CNA).

However, securities houses and futures traders will be exempt from these restrictions if they are conducting short selling activities for hedging purposes, according to the FSC.

The FSC's Securities and Futures Bureau reported that share prices for 105 stocks on the Taiwan Stock Exchange's main board, and 47 stocks traded through the OTC market, fell by 3.5 per cent or more on Friday 21 October 2022.

Consequently, these equities have been covered by the new short-selling rules when Taiwan's markets reopened on 24 October 2022.

Broadening the market

Paul Solway, communications officer at PASLA and BNY Mellon's head of securities finance for Asia, speaks to Carmella Haswell about the opportunities presented across the APAC market, PASLA's focus for 2023 and how Q1 is shaping up for the industry

Uncertainty remains a common theme for the industry in Q1 2023, as macro headwinds shift from the pandemic to geopolitical strains, while previous pent-up demand spurs inflation and soaring energy prices — not forgetting the ongoing conflict in Eastern Europe. Such uncertainties create equal amounts of risk-on and risk-off activity for the sector, says PASLA communications officer and committee member Paul Solway.

With most of the world having reopened, including Hong Kong, capital mobility is improving once again in 2023, which in turn is fuel-injecting corporate activity. Solway indicates that rising interest rates have been one of the substantial differences shaping the performance of securities lending markets in Q1 2022 versus Q1 2023. While interest rates this time last year were near-zero, today they are pushing 4 per cent in most major countries — with the exception of Japan.

APAC activity and returns have benefited in terms of cash reinvestment premiums, as well as demand for fixed income repo, explains Solway.

He adds: "From a market perspective, Taiwan achieved some fantastic returns in 2022 — with US$490 million in revenues and 288bps in average fees, according to DataLend — and despite having a relative respite so far in 2023, there is every chance that Taiwan will continue to give Japan and Hong Kong stiff competition for the top revenue slot in 2023."

Unlocking market potential

Opportunities present themselves in streamlining existing markets and opening new markets, according to Solway. "As China reopened its borders faster than expected, we hope this will be similarly reflected in the current financial boundaries and attitudes to incorporating best practices and standards from around the world," he asserts.

In the Philippines, new securities-based lending (SBL) rules have been "frustratingly slow" to develop through the local authorities as rules remain pending, according to Solway. He hopes that as normality returns, regulatory approvals will accelerate, allowing a more open market to evolve.

Other opportunities present themselves in Indonesia, where PASLA is working with local authorities to open up the market. Bank Indonesia and the Indonesia Stock Market Clearing House (KPEI) has issued new regulations regarding an onshore bilateral SBL facility that aims to match potential borrowers and lenders directly. Under previous SBL arrangements, the borrowing party needed to contact KPEI to initiate the trade, followed by a validation process to match with lenders.

"Despite this offering being largely aimed at domestic participants, PASLA welcomes such progress and will continue to work with local authorities to further open up this exciting market to the offshore community," Solway states.

Highlighting the impact of demand for high-quality liquid assets (HQLA) on the market globally — which continues to grow at a "phenomenal rate" — Solway notes that access to additional fixed income liquidity in the region is certainly a priority for Japanese and Australian government securities. Where the collateral is being "swapped in", borrowers and lenders need to be flexible, commercial and pragmatic towards their available inventory pools and risk appetites.

"We look forward to seeing wider demand, appetite and collateral acceptability across the region that will both spur activity, promote liquidity and ultimately bring positive economic growth to the multiplex of jurisdictions within the Asia-Pacific region," Solway states.

While the demand for HQLA skyrockets, the interest in transitioning to a T+1 settlement also continues across the market globally, with India becoming one of the more recent regions to transition to the shorter settlement cycle. From 27 January 2023, trade-related settlements in India markets will need to be cleared within a day of the transaction.

Speaking about this T+1 migration and the market's reaction to it, Solway says: "Clearly T+1 settlement cycles are becoming more top-of-mind these days, especially in the US, but such a move is not necessarily a surprise. Asia is already dealing with shortened settlement (e.g. China, T+0) or recall cycles (Taiwan, Singapore, Malaysia) across the region and so risk and operational frameworks are already aligned to lifecycle processes that need to be naturally nimbler and more automated."

As India remains a principally onshore market with respect to SBL, Solway believes there has been a limited reaction to the shift, given structural and commercial challenges that make it difficult for participants to scale up activity — and therefore liquidity — in this "very nuanced market".

Adjusting the focus

As the new year gets off to a positive start — S&P Global Market Intelligence report a 34 per cent year-on-year jump in global securities lending revenues for January, generating US$1.117 billion in revenues — firms continue to explore their positioning in the market and set their priorities straight for the following months. For PASLA, advocacy and education plays a key role in influencing the constantly evolving industry across the 10 plus markets in APAC. Therefore, resuming in-person meetings is a focus for the associationt.

The Association continues to focus on market evolution in China, which remains an important opportunity for a number of PASLA's industry participants. Nonetheless, Solway indicates that market activity continues to be split across those who can participate and those who cannot — "due to nuanced and complicated rules and regulations".

"Evolution does continue, with the Beijing Stock Exchange recently launching securities lending and margin trading (mimicking rules in Shenzhen and

Shanghai) but again, the applicability remains firmly aimed at a domestic level with limited expected participation," Solway explains. "PASLA is keen to continue its engagement and advocacy in 2023 to ensure that all voices are heard, allowing for a more level playing field for both buy- and sell-side players, onshore and offshore."

PASLA will prioritise commercial netting updates in 2023, in addition to tax work across markets such as Malaysia, Australia and Hong Kong, while environmental, social and governance (ESG) will remain a key lens that the association looks through for all market and industry developments.

The Global Alliance of Securities Lending Associations (GASLA) — which was formed in September 2021 — has focused on developing the next iteration of the Global Framework for ESG and Securities Lending (GFESL). Solway notes: "It is a real synthesis of perspectives from all of the member associations that has been formed by extensive discussion and consultation."

GASLA anticipates that the next iteration of GFESL will serve two main purposes for the industry. Firstly, it aims to be a valuable, practical reference point and guide for market participants — which was the original aim of GFESL and remains critical, says Solway.

Secondly, it will demonstrate to policymakers and regulators, globally, that ESG integration is a priority for the industry and that the associations are trying to define best practices that align with the policy goals that countries share. "In that respect, we hope it will support deeper engagement with regulators and other stakeholders, such as the UNPRI," Solway concludes.

As PASLA pursues its priorities for the year, the association's search for its first CEO continues. Solway explains: "This is clearly a critical appointment for PASLA and we are approaching it very carefully. The skills and background required for this role are also quite exceptional."

The desired candidate for the role is a person who understands the market and the challenges that practitioners face, in addition to having the ability to mobilise the organisation and achieve results. PASLA is speaking to candidates with a range of different backgrounds and hopes to find the right person soon — for now, the hunt continues.

"PASLA is keen to continue its engagement and advocacy in 2023 to ensure that all voices are heard, allowing for a more level playing field for both buy- and sell-side players, onshore and offshore"

Paul Solway
Head of securities finance for Asia
BNY Mellon

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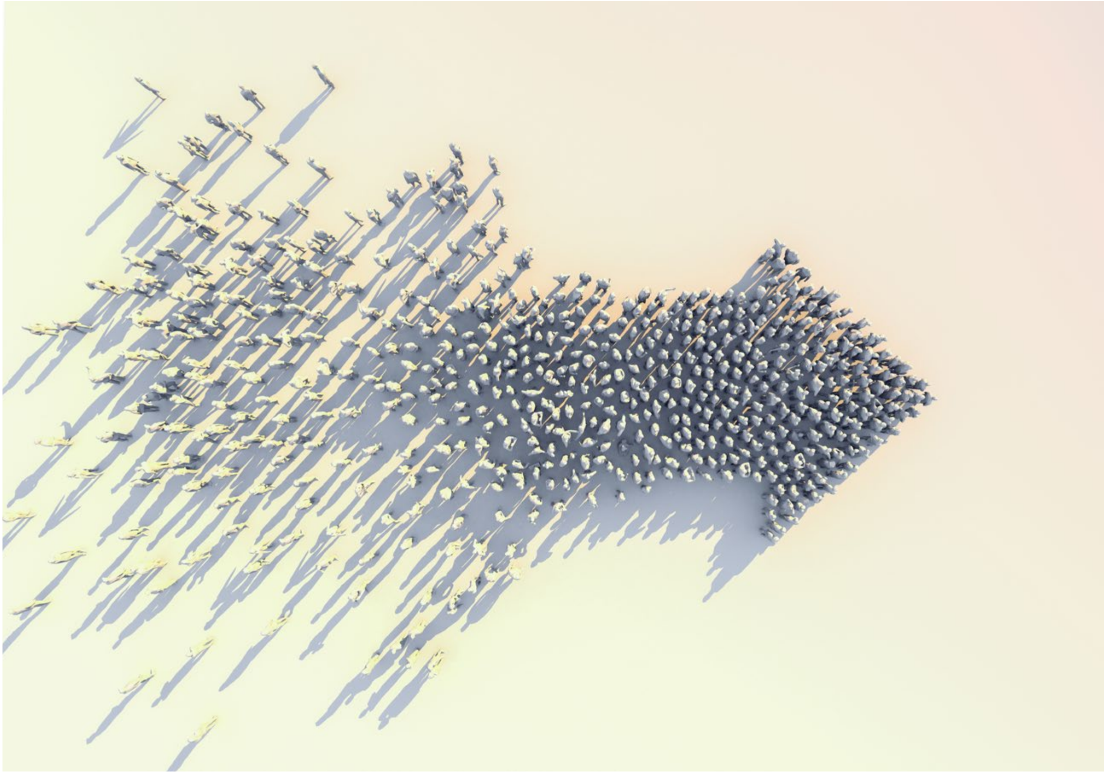


Progress in the face of uncertainty

Despite a particularly volatile environment, securities lending continued to thrive in 2022. Kyle Kolasingh, director of securities finance at RBC Investor & Treasury Services, shares his perspective on the past year and what lies ahead for 2023

It has been a strong year for securities lending, with annual industry revenues up by approximately 15 per cent globally, based on information provided by S&P Global. While volatility inherently brings challenges, it ultimately proved beneficial for securities lending, creating openings for a diverse range of financing transactions and lending opportunities.

For the third year in a row, we saw a turbulent first quarter, which was marred by the Russia-Ukraine conflict. An important point to take from this period of 2022 is the resilience demonstrated by securities lending. The industry moved quickly to align with a range of regulatory requirements and sanctions that affected both assets on loan and those used as collateral. This speaks to the strength of the lending market and bodes well for the future, demonstrating the sector’s ability to adapt and thrive in challenging times.

As central banks started to taper their quantitative easing programmes, market participants returned to the financing market to source liquidity. This made for a healthy fixed income market, giving rise to an increased appetite for Canadian government and provincial bonds on both an open and term basis. Where flexibility in collateral was permitted and duration could be taken, beneficial owners holding such assets continued to capture significant premiums on overnight fees. Corporate bonds have also been high performers as pressure on the credit environment had a positive impact on borrower demand in 2022. We expect this demand for fixed income assets to continue in the new year.

On the equities side, exchange-traded products (ETPs) remained a popular borrow, providing a convenient way to hedge or gain sector exposure. This is a trend that we expect to continue into 2023 — particularly for high-yield bond ETPs, given ongoing market volatility and economic uncertainty. Entering the new year, continued geopolitical uncertainty across the European region, coupled with an evolving inflationary and recessionary environment throughout much of the developed world, will likely contribute to further market volatility. However, as the past has shown, such volatility brings opportunity for securities lending as financing demand adapts.

Unlocking new supply

We are seeing increased demand for enhanced reporting and data access to support more informed decision making on the part of new and existing beneficial owners. An example is corporate bonds, where current market conditions may give rise to liquidity concerns. In a rising rate environment with volatility and credit pressure, access to the right data provides beneficial owners with clearer insight into the risk and reward trade-off associated with securities lending. Close communication with agent lenders is also vitally important. We continue to foster strong relationships with our beneficial owners to ensure that their understanding of the financing market aligns with their goals and risk parameters.

Another growing area relates to the retail side of the market. The meme stock craze of early 2021 demonstrated the scale and importance of retail investors' contribution to the financing market. This segment generated significant lending returns in 2021 and 2022. Known as "fully-paid lending" in the US, the retail segment has come to market in Canada. In particular, Canadian wealth managers are increasingly seeking opportunities to add incremental value and boost returns for their retail investor base through securities lending — a trend that is likely to continue in 2023.

T+1 and transparency

Although T+1 will not be implemented in Canada and the US until at least 2024, much of the heavy lifting to prepare for a shortened settlement timeframe will take place in 2023 through to 2024. While changes to securities lending activities are still under discussion, T+1 will ultimately reduce the time to recall a security by one day. Not unlike the move to T+2, the securities lending industry supports efforts to improve market efficiency. Other market changes planned for 2024 — including Canadian Depository for Securities (CDS) modernisation and a potential "fails regime" on Bank of Canada government securities — point to a busy time ahead here in Canada.

The industry will be watching closely as the US Securities and Exchange Commission (SEC) wraps up its Rule 10c-1 draft legislation, which aims to provide further transparency in the securities lending market. It remains too early to say how these proposed changes will affect Canadian beneficial owners, or the Canadian market of lendable securities. However, it is likely that the capabilities built and designed by industry participants for the Securities Financing Transactions Regulation (SFTR) in the EU and UK will be leveraged and, perhaps, even enhanced.

Another area that we expect to receive greater attention in 2023 is digital assets and digitised technology. T+1 may well be the beginning of a discussion leading to T+0, or same-day settlement, which could benefit from some form of distributed ledger technology. The International Securities Lending Association (ISLA) recently published a report that highlights considerations for digital assets, and this area will undoubtedly be a fascinating evolution for securities finance.

ESG isn't going away

ESG is a topic that I discuss with clients on a daily basis. We have always recognised that securities lending promotes sustainability of the wider capital market system by providing access to liquidity and balanced views for price discovery. However, as beneficial owners have been increasingly utilising proxy voting to fulfil ESG policies in recent years, there has been much discussion of its compatibility with securities lending.

Now this discussion is evolving. Increasingly, asset managers are employing securities lending as part of their overall ESG framework. For example, they may opt for a stronger position than divestiture from a sector — taking directional positions rather than long investments. They may also regard participation in securities lending as a contributing factor to overall sustainability of the capital markets ecosystem. This has effectively taken the discussion beyond compatibility concerns to the deployment of holistic, ESG-driven investment strategies that incorporate securities lending.

There is further discussion around the potential application of ESG principles beyond investment portfolios to collateral management. It is important to note that the creation of collateral exclusions based on ESG considerations has the potential to reduce the benefits of diversification and lead to increased concentration risk, which could ultimately diminish the risk-mitigating function of a collateral portfolio.

In November 2021, the Global Alliance of Securities Lending Associations (GASLA) published a best-practices guide on proxy voting and has been working towards a refreshed version of the Global Framework for ESG and Securities Lending (GFESL), which will encompass collateral management and related topics.

When all is said and done, ESG will continue to evolve away from the familiar proxy voting dialogue to a more holistic and positive force, which will inevitably be ingrained in almost everything that we do.

Diversity makes us stronger

Looking forward, I am hoping to spend more time amplifying the diversity, equity and inclusion discussion within the securities lending industry — this is particularly important to me on a personal level based on my own background.

This year, we saw Women in Securities Finance — which recently celebrated its fifth anniversary — not only continue to champion gender diversity, but also broaden the conversation to include more universal equity and inclusion. Ultimately, greater diversity will strengthen the securities lending industry through wide-ranging perspectives and place us in a better position to face a constantly-changing market in the years ahead. ■

"It is important to note that the creation of collateral exclusions based on ESG considerations has the potential to reduce the benefits of diversification"

Kyle Kolasingh
Director of securities finance
RBC Investor & Treasury Services

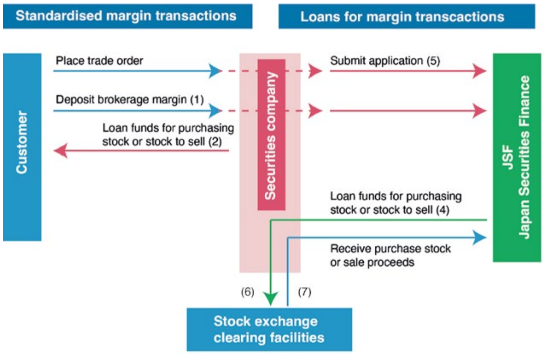
Rediscovering trade opportunities

Katsuhiko Yamamoto, general manager of margin loan at Japan Securities Finance, breaks down how firms can use margin transactions for short selling activity, enabling them to short Japanese shares at a reasonable price

If you need to short sell shares, a common way is to borrow these shares from a securities lending market. However, there is a unique method called “margin transactions” in Japan. What is the advantage of margin transactions? Anyone can freely short the majority of more than 4,000 listed issues without the need for complicated prior contracts, negotiations or paperwork with lenders.

Margin transactions account for approximately 15 per cent of the total trading value on the Tokyo Stock Exchange and are involved in more than 60 per cent of trading by individual investors — proving to have a large presence on the stock market in Japan. Margin transactions are classified into two sections, according to the regulations of the stock exchange: standardised margin transactions with a settlement deadline; and negotiable margin transactions with a settlement deadline set at the discretion of the securities company.

Japan Securities Finance (JSF) administers margin loan transactions in standardised margin transactions, providing the ex-post loans for the funds and shares necessary for securities companies. Prime brokers usually need to procure shares in advance before short selling, owing to the short selling regulations in Japan. However, loans for margin transactions are built into standardised margin transactions. Therefore, participants can immediately short sell shares without procuring them in advance since this presents no conflict with naked-short selling regulations.



Standardised margin transactions

A standardised margin transaction (SMT) is one in which an investor provides a 30 per cent deposit to a securities company as collateral according to their own market forecast. The investor then trades shares by borrowing the funds to buy the shares, or the shares for sale from the securities company. These transactions are an effective investment tool which enable leveraged transactions and short selling for individual investors. They are also widely recognised as a means of hedging risk.

If a market participant were to believe that the price of a certain stock will fall in the future, they can use a SMT to borrow and sell those shares from a securities company, rather than borrowing those shares from a prime broker and selling them on the market. A participant can then repurchase the shares when their price drops within the repayment period — up to six months — and give them back to the securities company. They would then receive the difference in those prices. Moreover, losses through hedge selling can be avoided by using SMTs for hedging purposes and margin acquisition purposes.

Loans for margin transactions

Only securities finance companies licensed by the Prime Minister are permitted to offer loans for margin transactions (LMT), JSF is the only such securities finance company in Japan. A securities company which has received a trading order for an SMT from an investor can procure the funds and shares necessary for settlement by providing a certain level of collateral to JSF.

How do you procure the funds and shares necessary for loans for margin transactions? Given our high credit rating (S&P A rating), JSF can borrow the necessary funds from financial markets. Meanwhile, JSF procures the number of shares necessary from securities companies and institutional investors through an auction process. The JSF auction is held the day after the trading date and the cost determined in the auction process is called the premium charge rate. This rate is set in advance by the table corresponding to the amount of investment.

Margin sellers pay a uniform premium charge according to the standardised margin selling balance. On the other hand, auction participants and margin buyers can receive these premium charges according to the number of shares they successfully bid for and the standardised margin buying balance.

The premium charge rate is an indicator of the supply and demand of the stock loan market in Japan. If the premium charge rises sharply, it has the effect of encouraging margin sellers to clear their accounts and new margin buyers to enter the market. In general, the balance between margin buying and margin selling reaches an equilibrium through self-adjustment with such premium charges. Nevertheless, if the outlook for procurement through the auction process is unclear due to special factors — such as sudden price fluctuations, corporate actions and listings which carry over into the next fiscal year from application — JSF will issue a warning or suspend applications in the use of stock loans according to the situation, thereby controlling the increase in excessive selling through such measures.

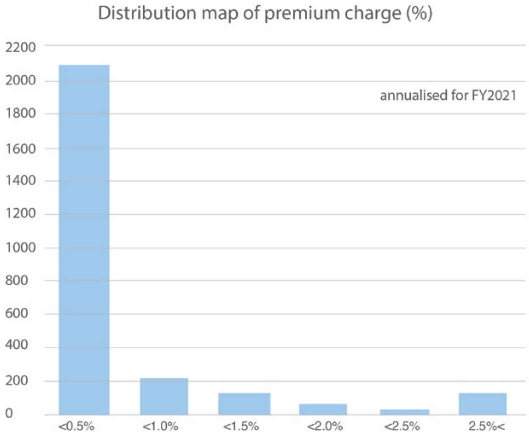
Utilisation of margin selling

Market participants can freely short 60 per cent of more than 4,000 listed issues in SMTs — but that figure becomes more than 90 per cent if only looking at the highly liquid prime market. It is an important choice to consider when any issues are eligible for margin selling and there is no availability on the stock lending market. If that happens, firms should consider shorting it by using an SMT.

As previously described, the costs incurred in margin selling consist of the premium charge (there are also many issues which may not incur a premium charge) and the lending fee set by the securities company — which differs for each securities company.

The premium charge is determined on the day after the trading date. Uncertainty remains for firms because the procurement cost is finalised ex-post facto. However, looking at the historical data, there are many cases in which the costs involved in margin selling are lower than the cost of borrowing on the securities lending market. In particular, it is possible to find many issues which are comparatively less expensive if using margin selling among those which are difficult to borrow with high market rates.

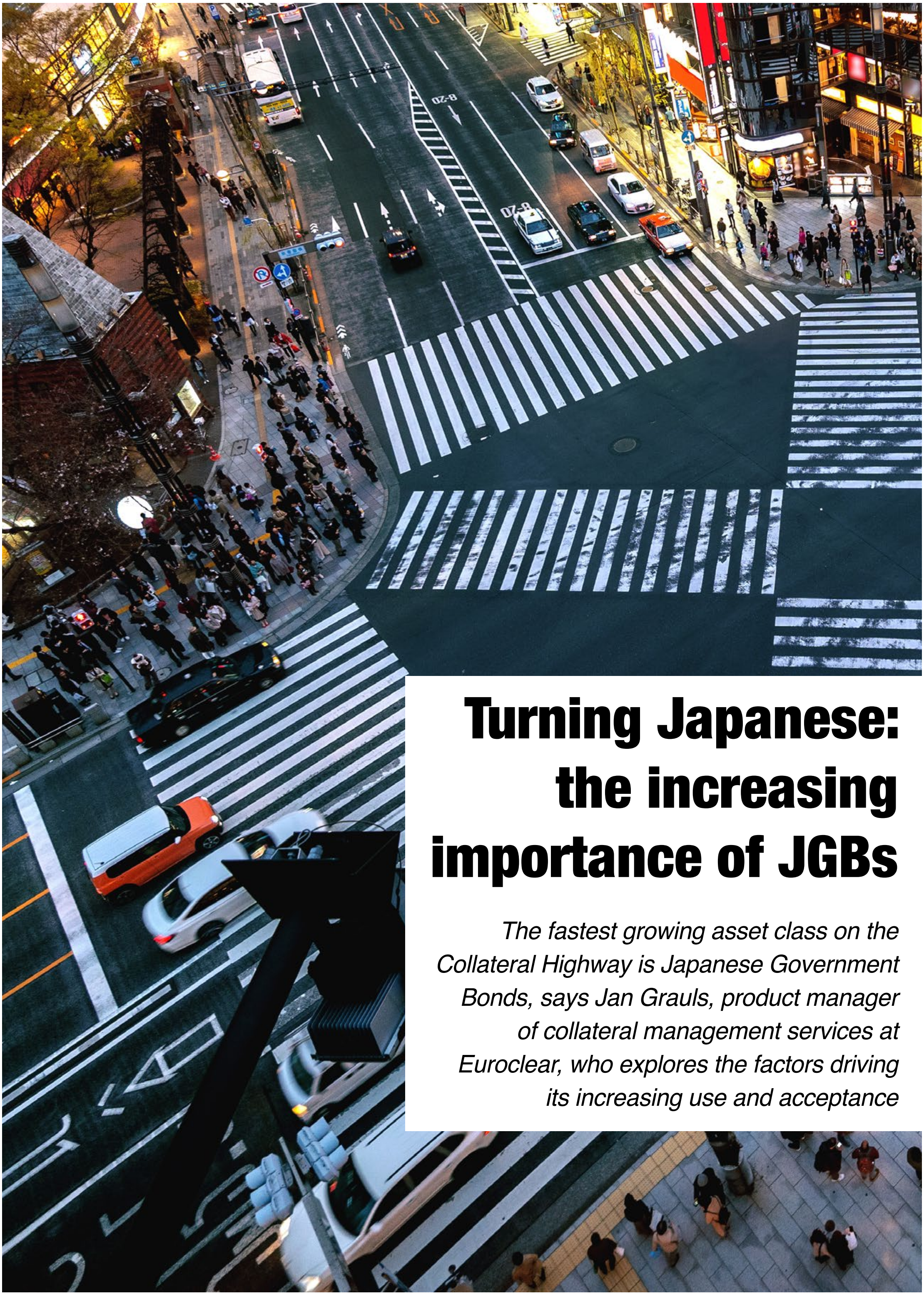
One of the reasons for this is that almost no professional investors have entered the SMTs market, most users tend to be individual investors in Japan. The preferences of professional investors and individual investors are often divided. Firms can now short Japanese shares at a reasonable price with SMTs without paying high fees on the securities lending market. The historical data of LMT can be obtained from Nasdaq Data Link (https://data.nasdaq.com).



The mechanism of SMTs is complicated, as we have explained. Nevertheless, it is a very interesting system, unique to Japan, which enables firms to short a wide range of issues. Firms can start to engage in these transactions at any time by opening a margin trading account with a securities company in Japan.

"Firms can now short Japanese shares at a reasonable price with SMTs without paying high fees on the securities lending market"

Katsuhiko Yamamoto
General manager of margin loan
Japan Securities Finance



Turning Japanese: the increasing importance of JGBs

The fastest growing asset class on the Collateral Highway is Japanese Government Bonds, says Jan Grauls, product manager of collateral management services at Euroclear, who explores the factors driving its increasing use and acceptance

Japanese Government Bonds (JGBs) are a highly rated, highly liquid asset class. Japan's outstanding debt is twice the size of its economy. Historically, most of that debt has been issued, held and traded domestically. Over the past decade, the perception of the JGB market, as domestically focused, has increased as the Bank of Japan (BOJ) — similar to other central banks around the world — undertook an extensive programme of quantitative easing by the outright purchasing of JGBs.

According to the BOJ's latest Flow of Funds Accounts that were published in December 2022, the central bank owned ¥535.62 trillion (US$3.92 trillion) of JGBs by market value at the end of September. This represented 50.3 per cent of the total JGB issuance of ¥1.07 quadrillion. This is up from 49.6 per cent at the end of June 2022 and an increase from 10 per cent ownership in 2012.

In some specific cases, the BOJ owns 100 per cent of certain individual issues such as the 368th 10-year issue that was sold in October 2022. This is evidence that the BOJ is vigorously following its yield curve control policy to keep the 10-year part of the yield curve from rising too much in the face of the recent rate rises.

However, a different dynamic is emerging which flies in the face of the perception that the JGB market is almost entirely Japanese. Holdings of JGBs by foreign institutions have been steadily increasing over the past decade. According to BOJ data, the proportion of the total JGB market (including FILP bonds and T-bills) held by foreign financial institutions has risen from 5.7 per cent in March 2010 to 14.1 per cent in December 2022. It reached a high of 14.4 per cent in March 2022. In absolute terms, this represents an outright increase in foreign holding of ¥123 trillion (US$957 billion).

There are both macro and micro reasons for this change. On the macro side, a series of fiscal, monetary and structural reforms that were enacted a decade ago by the late Prime Minister Shinzo Abe (called Abenomics), have brought about fundamental changes to the Japanese economy across several vectors.

A key element of the so-called third arrow structural reforms was an intent to increase the internationalisation of Japan's economy. In financial services, this has manifested itself by Japanese financial institutions going out, while foreign financial services firms have come in. As a result of this, JGBs have assumed a greater role not only in capital structures, but also in general financial operations.

At the same, the global need for high quality liquid assets for use as collateral for uncleared and cleared margining has increased dramatically, not least due to the successive waves of Uncleared Margin Rules (UMR) rolling out over the last five years. The use of JGBs as collateral in Euroclear has doubled since 2021 and across the different business lines of repo, securities lending and UMR. JGBs have therefore become the largest sovereign collateral.

Is it a misconception to think that the BOJ has taken the liquidity out of the JGB market?

The BOJ now owns half of all the JGBs, which they have bought to force a large amount of liquidity into the Japanese market in the hope of stimulating consumption. However, recent statistics from the BOJ indicate that despite the growth of the Bank of Japan's holdings, the proportion of foreign-held JGBs has also been increasing.

What intrinsic qualities do JGBs have that make them particularly suitable for use in collateral?

JGBs provide a number of intrinsic qualities that make them particularly suitable for use in collateral. Firstly, the asset class is a sovereign collateral, which means that there is a lot of trust in the bonds. Secondly, JGBs have become a very large market and are very liquid, so counterparties can be quite confident that they can sell the asset if things go wrong. Another advantage that market participants identify is that these bonds are quite cheap in the sense that they are abundant.

Generally, any financial institution that is involved in some way in Japan also tends to hold or have access to a large stock of JGBs. In the past, these institutions might have struggled to find ways to use this stock, but now because JGBs are being used more internationally, there are many more avenues to place them with counterparties.

Why are JGBs being used more internationally?

The increase in the international use of JGBs is due to several factors. Historically, market participants would have been less willing to accept the asset class because, in doing so, they would be accepting something that they are not very familiar with and that is denominated in yen — so there is a currency risk to manage. These were also less prevalent in the Japanese market at that time, which would not ease liquidation if things went wrong.

Euroclear's assessment is that we are seeing greater use of JGBs as collateral. A growing number of international firms have activity in Japan and are comfortable in trading those assets. Vice versa, there is a scaling number of Japanese firms that are finding their way into international activity. These are using their domestic stocks of JGBs and convincing their counterparties to accept them. Euroclear is a platform that is the ideal place for these firms to meet and transact.

Have there been any specific regulatory changes or is this part of a long-term trend?

There has been a long-term trend towards greater JGB use in collateral, but UMR has accelerated that adoption. UMR has prompted a lot of trading relationships that were previously unsecured to become secured by collateral. The majority of these trading relationships are between, for example, Japanese clients and their international trading counterparties. A lot of the collateral that has been exchanged within those relationships is now JGBs. That has certainly contributed to greater interest in using JGBs.

What are the challenges that people might need to be aware of when considering increasing the use of JGBs in their collateral stack?

When increasing the use of JGBs in a firm's collateral stack, this presents an obvious challenge of managing inventory related to operating hours. The Japanese market opens in the middle of the night in Europe and is even more challenging with respect to the US. But even then, Euroclear has the capacity to move JGBs out of and into the domestic Japanese market in size and on the same day. There are some challenges around managing an asset class that is in yen, as there is currency risk involved. Additionally, there can be some quite onerous documentation requirements in the local language.

However, following the clarification of the fiscal treatment of securities financing transactions, Euroclear was able to work with our Japanese depository to significantly reduce the burden related to the required certification to hold JGBs as collateral in Euroclear. This simplification of documentation has been an important catalyst for growth in the use of JGBs on the Collateral Highway and it has unlocked significant pools that were, previously, out of reach.

Euroclear has also made it easier to pledge JGBs by giving legal clarity on the validity of such a pledge. If a firm wants to have a pledge on Japanese collateral, it is not sufficient to just have good documentation with a counterparty. Firms would also need comfort that the pledge complies with Japanese law.

Euroclear worked to set up a structure — and get the necessary legal opinions on that structure — to enable clients to feel comfort that if they were pledging collateral, this pledge would be fully compliant with Japanese law. This further increases liquidity and their foreign usage. JGBs' safety, liquidity and ease of use are three characteristics that make them ideal collateral and why they are so popular on the Collateral Highway.

Jan Grauls
Product manager of collateral management services
Euroclear

JGBs in Euroclear Bank

Before the Bank of Japan began its bond buying programme, it was the Japanese banks that had huge JGB inventories on their balance sheets. At the same time, these banks had substantial foreign currency funding needs, mainly in US dollars. They used cross-currency repos to meet their funding requirements and, in the process, brought JGBs into Euroclear Bank as collateral. This trade still carries on.

Euroclear does not just service Japanese banks. When Japanese institutional investors move into Europe, they are keen to take foreign-owned JGBs as collateral and turn to Euroclear to make the connections for them. These Japanese institutional investors, such as insurance companies, accept JGBs as collateral for non-cleared derivatives margining, but also for collateral swap transactions. This brings even more liquidity and flow into Euroclear Bank. Since there is no domestic triparty platform in Japan, any entity that wants to finance their JGBs must do so in an international environment, which Euroclear provides.

In the last decade, Euroclear Bank's settlement link with the domestic market has further improved while documentation requirements to hold Japanese assets have eased. Euroclear has operated a representative office in Tokyo since 1987 to support Japan-based users of its securities settlement system. In November 2017, Euroclear Bank, the international central securities depository, was granted a licence from Japan's Financial Services Agency (FSA) to establish a foreign bank branch under the Japan Banking Act.

A tokenised collateral network

With little fanfare but significant long-term impact, J.P. Morgan's Paul Pirie and Bhavna Haswani discuss the recently completed landmark transaction, moving a tokenised money market fund onto a blockchain. Leveraging this initial transaction, J.P. Morgan is exploring how to expand this offering in the coming months

The Tokenized Collateral Network (TCN) is a major milestone in our digital strategy and will be a central utility in creating a digital collateral hub for J.P. Morgan clients and the market.

In January 2021, J.P. Morgan revealed its Collateral Token Agent (CTA) functionality — which enabled the tokenisation of baskets of assets in triparty — to facilitate the execution of trades on the J.P. Morgan distributed ledger technology (DLT) repo platform. With the arrival of the TCN, J.P. Morgan's trading services business has the infrastructure to potentially tokenise any asset in any market. It will transfer that 'token' instantly from the collateral provider wallet to any collateral receiver wallet, as participants on the network.

This is incredibly powerful. It will not only vastly increase the potential mobility for traditional collateral securities, but it also opens the door for new asset types or markets to be used as collateral.

The TCN is perceived as a market utility which enables participants to create a virtual digital pool of assets and to mobilise them. The network operates independently of J.P. Morgan's agency products and services.

The role of TCN

TCN is a utility for every actor in any collateral transaction, including collateral providers and receivers, collateral agents, vendors and triparty agents. TCN improves all collateral flows covering bilateral or triparty, inter or intra entity, variation or initial margin.

The network incorporates smart contracts to facilitate real-time collateral exchanges, either as a pledge or title transfer. This model is supported by independent legal opinions, which confirm that the right of ownership is not impacted by the DLT nature of the process. Furthermore, the TCN aims to significantly reduce settlement risk from the market by leaving assets with the client's custodian and tokenising them in location, before mobilising them as collateral on the blockchain.

TCN creates mobility in less liquid assets, thereby allowing so called 'trapped' assets to be financed, reducing the cost of carry and improving investment viability. Collateral providers using the network will be able to create a single global pool of collateral that can be mobilised to any counterparty instantaneously and independent of market operating hours.

Further benefits of J.P. Morgan's newly launched network includes the possibility to enable the tokenised collateral to be delivered into standard collateral models such as triparty by using standard asset reference data.

While the applications are potentially endless, the initial focus is on mobilising the harder to finance assets as collateral and bringing these into the existing collateral flows. J.P. Morgan is now working with a core group of market participants in design partner groups, to prioritise the most valuable use cases for the TCN, allowing it to evolve and scale up incrementally in the coming months.

The utilisation of securities

In close collaboration with key clients and stakeholders, we have successfully tokenised CNAV Money Market Fund (MMF) shares and executed a title transfer move of those shares between two TCN participants on blockchain. This is an industry first and demonstrates the power of our Onyx blockchain platform and our team's ability to innovate on behalf of J.P. Morgan clients.

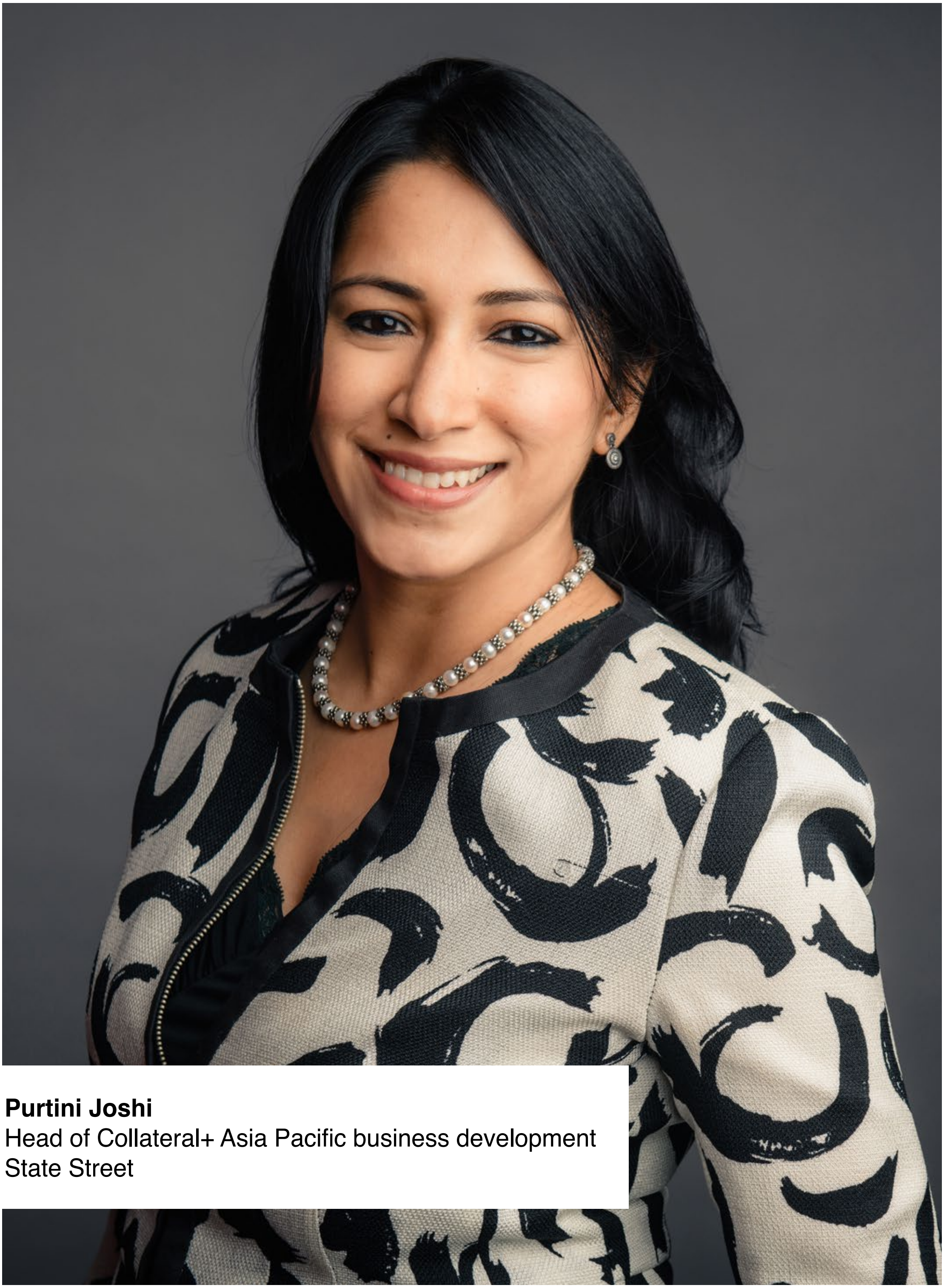
MMF shares are an example of a low risk, highly liquid asset that is very cumbersome to mobilise as collateral. By tokenising MMF shares, the TCN has tangibly increased the utility of MMFs for natural investors and provided an alternative to cash for collateral providers.

Financing natively issued digital bonds

There are increasing numbers of fixed income securities being issued directly onto blockchain and the J.P. Morgan tri-party platform is working with issuers, primary market makers, clients and holders to create a secondary market for the use of natively digital bonds as collateral.

Bhavna Haswani
Product Manager, Collateral Services
J.P. Morgan

Paul Pirie
Head of Securities Services Luxembourg,
Collateral Services
J.P. Morgan



Purtini Joshi
Head of Collateral+ Asia Pacific business development
State Street

Evolving perspectives

APAC markets are shifting to put collateral management at the forefront. Purtini Joshi, head of Collateral+ Asia Pacific business development at State Street, evaluates the evolving collateral space and how digital assets are adding new dimensions to the investment cycle

Collateral has become the fundamental pillar for managing capital, risk, financial stability and, more recently, generating alpha. An unprecedented focus on collateral management, brought about by the Global Financial Crisis and accelerated by regulatory reforms, has accomplished systemic risk reduction in capital markets.

The effectiveness of collateral in mitigating credit and liquidity risk was evidenced during the peak of COVID. The initial weeks of market panic triggered a monumental increase in collateral demands and provided an effective protection against defaults. However, a number of vulnerabilities emerged within firms that were regulation compliant but lacked automated processes. COVID-induced market uncertainties led to a significant increase in volatility, resulting in volume spikes and a downward pressure on asset valuations.

As an example of the challenges firms faced, in times of volatility the increase in margin calls and disputes placed further pressure on funding requirements. As lockdowns took over, workflows and manual processes that were based on fragmented information, with physical and organisational separation of roles, created further differences between market participant systems and exposed firms to incremental financial and counterparty risk.

Looking into 2023 and beyond, collateral automation continues to be the dominant theme in APAC as firms look beyond compliance and assess the efficiency of cost and operations. In the same vein, collateral optimisation is poised to move from a conceptual idea to concrete outcomes. These themes are hardly new to buy-side firms, having been persistently emphasised in response to regulation. However, as firms start to live the impact of regulation and are faced with evolving market conditions, they must rethink their approach to collateral.

Emerging trends in collateral management are changing the rules of the game impacting the present practices and assumptions. For one, the recent buzz around convergence of securities finance and derivatives has yet again underscored the importance of holistic collateral management. In addition, ESG narratives and distributed ledger technology (DLT) innovation are adding new dimensions to the investment cycle, including collateral management. As these ideas mature and are incorporated into the collateral function, firms should bear in mind that their ability to adapt to future capability will depend on the foundational blocks of automation and optimisation.

Trinity of collateral strategy

A reflection on COVID has reinforced the importance of automation across the collateral value chain — from margin agreement through to settlement. It has also highlighted the importance of optimisation and collateral transformation during periods of high market stress.

Arguably, automation and optimisation are fundamental blocks of any firm’s collateral strategy. Automation streamlines processes and reduces complexity, while optimisation helps to manage funding cost and asset utilisation. As collateral movements become dynamic, collateral management teams need to stay close to middle- and front-office activities. Where clients pledge securities, the middle office needs to track trading activity and monitor coupons and maturity dates. Equally, timely confirmation of settlement is of paramount importance, more so in volatile market conditions.

Counterparties want to ensure that the collateral is in place to cover daily mark to market and potential future exposure. In the run up to the last two phases of UMR, State Street worked extensively with clients to streamline and standardise collateral workflows to prepare them for an uptick in volume. State Street's Collateral+ moved clients away from manual spreadsheets, custodian portals and email communication, and enabled integrated middle-office services, providing operations teams clear sight into the inventory of assets available for meeting obligations.

However, as the buy-side adapts to the new normal of the post-regulatory world, focus is visibly shifting to optimisation in response to frequency and value of collateral movements. Restricted by allocation mandates, local regulation, capital restrictions and sub-optimal infrastructure, firms have had to carefully consider the impact of collateral costs on investment performance. Typically, a firm would look to deploy existing unencumbered assets in the portfolio before going externally. Unfortunately, firms in APAC have not been able to derive maximum benefit from their assets due to a variety of factors. Strong preference for G7 currencies, being the most traded and liquid, has prevented APAC firms from using their domestic currency assets with cross-border counterparts.

In most cases, collateral posted in APAC currencies typically attracts a higher trade charge from banks that price trades higher due to liquidity constraints inherent in local assets. Local market infrastructure for mobilising cross-border collateral movements is restrictive and, where permissible, is typically confined to government bonds with varying settlement cycles across the markets. Cross-border counterparties often cite absence of local custodian banks as an obstacle.

Moreover, managing collateral processes across time zones is particularly challenging between cross-border counterparties and local market cut-offs at custodians. This has pushed APAC firms to review the costs associated with acquiring globally accepted assets and its impact on portfolio performance. Consequently, collateral transformation has become key to managing the supply of accepted collateral within the constraints of mandates, balance sheet restrictions and counterparty risk. An asset manager long in equities, which are in general ineligible as collateral, can lend them to a custodian bank in return for high quality government bonds.

Another visible change in APAC is the steady shift away from USD cash to securities. Through the best part of the last decade, portfolio managers were reliant on cash to meet variation margin, citing operational efficiency and pervasive low interest rates. This has started to shift. Rising interest rates have changed the cost of funding, thereby altering the preference for cash in favour of securities. As securities start to replace cash to prevent its drag on portfolio, it will become imperative to optimise the inventory of assets across variation margin and initial margin, if applicable. Operationally, collateral teams will need to manage timely settlements and substitutions in response to corporate actions.

Also important to note, UMR has brought collateral segregation into focus. Effective segregation prevents commingling and establishes robust protection for collateral under a legal framework. Much like their global peers facing UMR obligations, APAC firms have used existing custodian relationships to pledge collateral from the main account to segregated accounts. This process, also known as third-party segregation, by design, is inherently inefficient, expensive and operationally burdensome.

Segregation arrangements typically encumber assets by moving them to a bankruptcy remote location and allow limited re-use, materially impacting the collateral giver's liquidity and financing decisions. Collateral selection is bilaterally agreed between counterparties and movements are self-instructed to the custodian. For a firm working within the constraints of a portfolio mandate, this approach restricts unimpeded asset mobilisation and substitution, fragmenting the collateral pool across margining counterparties.

Recognising these limitations, State Street added triparty services to its Collateral+ platform ahead of UMR Phase 5. Triparty allows for optimised collateral selection across all counterparty obligations utilising assets held in custody with State Street or externally. Collateral can be switched efficiently and is agnostic to the underlying transaction, which means OTC, securities lending and bilateral repo can leverage the same service.

Convergence of securities finance

Margining is converging with financing and collateral is at the intersection. The International Swaps and Derivatives Association's (ISDA's) efforts to bring securities finance transactions (SFTs) and derivatives under a Common Domain Model (CDM) and single ISDA Master Agreement promises to bring quantifiable benefits to market participants by expanding the netting set across securities financing and derivatives.

Creating greater flexibility as to how clients can deploy their inventory is now essential. For example, funds may trade repo and reverse repo, reinvest cash or use it for margin, portfolio securities can be transformed to higher-grade collateral or traded in swaps to hedge or enhance yields. These examples just scratch the surface of possibilities. However, in practice, systems and operations for derivatives, SFT products have been organised in silos, reflecting the different process and market practices associated with each product type. Consequently, collateral function — although ubiquitous across the product types — is also dispersed and siloed to cater to operational nuances and regulatory treatment.

Notwithstanding the differences, a good place to start is inventory aggregation and cross utilisation. Triparty lends well to buy-side firms who want to start making efforts towards convergence. Well established for margining repos and OTC alike, a triparty framework addresses the key challenges — eligibility, optimisation, substitution, legal framework and settlement. More importantly, in APAC, it can potentially mobilise underutilised assets in restricted APAC markets like Taiwan and South Korea by harmonising settlement infrastructure and facilitating the use of local currency securities to the pool of globally accepted assets.

Collateral and digital innovation

One of the reasons triparty has gained significant prominence in collateral management is due to its efficiency in effecting settlement finality for legal purposes. This is significant in ensuring irrevocable and unconditional access to collateral following bankruptcy or insolvency of a participant. In addition, triparty improves costs and operational efficiency by reducing friction typically observed in bilateral transactions.

However, it does require the collateral giver to maintain a fully funded long box by the physical movement of assets from custodians to triparty. DLT has the potential to address both. It can ease the prefunding by facilitating near real-time settlements between custodian and triparty. Collateral givers can fund the long box just in time, easing liquidity pressure and reducing cost of capital. In the same token, where collateral moves bilaterally between custodians of the counterparties, DLT can affect the settlements in near real time, reducing credit risk.

Another potential use case for DLT is in bringing regional assets trapped behind local infrastructure and foreign exchange controls to the global stage. As noted earlier, with the exception of a few, domestic assets in APAC are not widely accepted for collateral due to infrastructure limitations and liquidity concerns. DLT can provide an alternative path by enabling diversified assets mainstream, in turn improving liquidity. With the progressive shortening of settlement cycles, collateral is in the footsteps of real-time payments that were witnessed two decades ago. DLT has the potential to overcome the relatively clunky settlement and reconciliation processes in the custody chains to bring about real-time collateral settlement.

ESG

As the ESG agenda continues to evolve globally, the APAC region is set to catch up with peers in other regions. Adoption of ESG in APAC is in the infancy stage, with some jurisdictions leading the charge with enforcement of mandatory disclosures, while in others, penetration is low due to lack of a consistent framework.

Accelerating client demand is the prime driver for integrating ESG into the investment process, both pre- and post-trade. In the context of collateral, it is important for beneficial owners to have visibility to confirm that the collateral they receive is sustainable and that it is aligned with its own ESG metrics.

> *"Automation, optimisation and segregation are fundamental to any firm's collateral strategy and set the foundation to adapt and expand"*

At present, there is no consistent measurement framework for screening ESG compliant collateral assets. The industry is expected to adopt bespoke solutions that cater to a firm's specific criteria and relevant ESG parameters.

In APAC, firms who are starting out on their ESG journey generally look to exclude holdings of companies that exhibit poor governance or are known to pollute through their economic activities. However, the ESG journey is expected to expand well beyond negative inclusions and threshold limits to unfavourable sectors. Its impact on credit ratings has the potential to dynamically alter collateral haircuts to capture relevant market information. Increasingly complex ESG data and ratings from research providers will be incorporated in the technology platforms which require flexibility and open architecture. State Street's Collateral+ platform provides access to ESG ratings from multiple resources, enabling clients to customise their approach.

State Street is also developing digital collateral schedules which allows dynamic changes to ratings and eligibility sets. A collateral receiver may set a minimum rating level, but this may be modified dynamically to reflect changing preferences and in response to market events.

Bringing it all together

Having emerged from two crisis events in recent years, both of which brought additional focus on collateral as a risk mitigant, there is a palpable shift in the industry to give the subject its due importance.

Automation, optimisation and segregation are fundamental to any firm's collateral strategy and set the foundation to adapt and expand. As collateral requirements for margining and financing converge, incorporating ESG and digital assets frameworks, buy-side firms will need agility and foresight. With the exception of a few large firms in the region, most buy-side firms have modest technology spends. In the same token, administrative and operational burdens are onerous and distract asset managers from their daily tasks.

As firms start to revisit collateral management in the context of alpha generation, they need to be slick in the midst of complexity. Outsourcing is one way to transfer this complex yet strategically important function, which in recent years has become sophisticated in response to unrelenting regulatory pressure. It offers end-to-end capability, a variable cost structure and stays lockstep with regulatory changes.

State Street's Collateral+ platform is a holistic and flexible solution combining services and technology platforms. It helps clients tackle operational challenges within their legacy systems, provides a straight-through processing (STP) workflow, fully integrating front-office funding through middle- and back-office functions. Underpinned by centralised inventory management and optimisation, it is connected to all major service providers and custodians through open market connectivity. State Street continually invests in capabilities to provide clients with access to best-in-class services. ■

China's repo market: a guide to the present, an eye on the future

Richard Comotto, senior consultant to the International Capital Market Association, speaks to Bob Currie about the release of the China chapter of ICMA's guide to Asian repo markets and his thoughts on how this financing marketplace might develop

The International Capital Market Association (ICMA) has released a guide to China's repo market, representing the fifth chapter in its domestic repo markets in Asia.

This latest chapter provides a detailed introduction to repo market activities on the Chinese mainland, including analysis of the evolution of the market, both its interbank and exchange-traded markets, products and trading activities and market infrastructure, along with a review of the regulatory and legal framework and its ongoing development.

Authored by Richard Comotto, senior consultant to the ICMA's European Repo and Collateral Council and longstanding repo market expert, this contribution follows on the back of domestic repo market guides for Japan, Indonesia, Vietnam and the Philippines which have been released in stages earlier this year.

The latest chapter notes that China has a 30-year history of repo trading, with activity building from informal transactions conducted on local exchanges in the early 1990s to a market today that generates almost US$220 trillion annually in turnover, equivalent to an average daily turnover of US$850 billion or CNY 5.6 trillion.

Given the scale of the repo market in China, Comotto advises that it should be compared with other large repo markets globally, rather than its smaller Asian regional counterparts. The repo market is now the largest fixed income and money market in China, with repo turnover during 2021 of CNY 1,395.4 trillion compared to CNY 214.5 trillion cash trading in bonds and CNY 118.8 trillion in unsecured interbank lending.

While China's domestic repo market has grown substantially from where it was 30 years ago, he suggests that the market may now have entered something of a cul-de-sac in terms of the opportunities it offers for further development. It is not a conventional repo market, he notes, insofar as some of the functions it fulfils would typically be performed through other instruments or trading mechanisms in other jurisdictions. In its current form, it has potential to grow further as a domestic market, but it offers only limited possibilities for integration with the international financial markets and to evolve as a funding channel that is attractive to international participants.

Collateral illiquidity

The guide concludes that, although the repo market is the most efficient and liquid financial market in China, the underlying cash market for securities deployed as collateral is relatively illiquid, with very low turnover, and collateral illiquidity is a systemic risk in this market.

The consequence, says Comotto, is that liquidity-providers (ie collateral takers) will typically avoid term business and limit their financing trades to overnight, in the hope that they will exit the transaction before anything goes wrong.

More specifically, given the lack of liquidity in the underlying cash securities markets, it is difficult to accurately value collateral. Collateral-takers may have broad confidence in the default characteristics of government bonds, municipal bonds and policy bank bonds delivered as collateral in repo transactions — believing that the Chinese government is likely to back its government debt, along with debt issued by government agencies and state-owned enterprises.

However, given the illiquidity of underlying securities markets, it is challenging to manage the mark-to-market and to track the movement in collateral valuation over time. These factors, collectively, represent a significant constraint on the future development of the market.

Although the one-day duration of most repo transactions does mitigate this liquidity risk to investors, it does present a significant funding risk for borrowers. Comotto notes that extensive use of short-term wholesale funding to generate leverage and to manage maturity transformation exposes the repo market to risk of sudden deleveraging.

A further source of systemic risk arises because almost all repo trades are pledged transactions, which are effectively secured loans rather than true repo. In the event of a counterparty default, Comotto notes that such repos would fall within the scope of the statutory insolvency regime and Chinese bankruptcy law, which is little tested and may delay or block access to collateral.

A new Futures and Derivatives Law (FDL) came into effect in China on 1 August 2022 which recognises the enforceability of close-out netting, but only for futures. ISDA has also published a netting opinion for the derivatives market in China that aligned with the enactment of this FDL legislation.

These developments notwithstanding, Comotto remains cautious about how far the market has advanced in terms of the surety available to repo market participants.

“This does not currently offer market participants the assurances that they require from a mature financing market,” says Comotto. “This demands that their rights to the collateral are clearly protected, typically through transfer of title, and that is not currently the case in China. Further, in case of counterparty default, it is unclear whether close-out netting could be assured for mutual positions under China's existing insolvency law, notwithstanding progress with derivatives. The regulatory authorities have issued statements indicating that the rights of collateral takers will be protected in case of a counterparty default, but that assurance is untested in practice."

More broadly, pledged repo does little to encourage liquidity in the underlying securities market because cash lenders are not able to re-use pledged collateral, for example to cover short positions.

Trading and post-trade infrastructure

The repo market in China is divided across the Interbank Market and two stock exchanges, the Shanghai Stock Exchange and Shenzhen Stock Exchange. The Interbank Market is a largely wholesale and quasi-OTC market. The exchanges are centralised markets and primarily support retail activity.

SFT asked Richard Comotto how he expects the relative market share of the Interbank Market and stock exchanges to evolve for repo trading in times ahead. The exchanges raised their share of trading turnover to 35 per cent in 2017, before falling back in the face of tighter monetary policy and regulation to just over 20 per cent at the end of 2021 (p 5).

"Looking back five years or so, it seemed likely that the stock exchanges would strengthen their market share of the Chinese repo market on the back of greater interest in credit collateral," explains Comotto. "However, in practice, that trend was not maintained. Shocks to the market, including the challenges presented by the Covid-19 pandemic, have focused repo trade through the longer established and more liquid Interbank Market, which has also been encouraged by central bank participation through this channel."

With the move to "risk off" that has accompanied these shocks, this has slowed growth of repo trading through the stock exchanges. If risk appetite returns, Comotto predicts that the exchanges may again start to encroach on the market share of the Interbank Market. On the other hand, if the Chinese government increases its issuance of government bonds, this is likely to provide additional stimulus to repo trades against government debt collateral through the Interbank Market.

In theory, Comotto notes, the Interbank Market trades on the China Foreign Exchange Trading System (CFETS), which supports trading and data services for repo, cash bonds, foreign exchange and OTC derivatives. In reality, repo market participants commonly trade bilaterally off CFETS, using voice or chat, with CFETS used to report the transaction in keeping with the regulatory obligation in the Chinese market for OTC transactions.

Comotto believes there is small probability that repo trading activity will move substantially from voice to electronic trading on CFETS in the immediate future. To support electronic trading, it is necessary to offer strong liquidity in standardised trading instruments and contracts — and this is currently not available in China's domestic repo market. Credit availability is also a constraint, particularly in the Interbank market.

The financial authorities in many emerging capital markets are keen to demonstrate that they are building an international-standard trading and post-trade infrastructure. However, automatic trading systems operating via a central limit order book cannot operate efficiently without strong trade flow. Comotto notes that in the US and Europe, this has been driven particularly by a large and vibrant repo market supporting short-term financing of government bonds. However, China's domestic market cannot currently deliver this level of repo market liquidity.

At clearing level, two CSDs are currently providing clearing and settlement services for the Interbank Market. China Central Depository and Clearing Corporation (CCDC, or Chinabond) is the designated CSD for government bonds and enterprise bonds and settles approximately 80 per cent of the Interbank Market. The Shanghai Clearing House (SHCH) settles repo against other collateral, typically commercial paper and medium-term notes. Both CSDs offer DvP central bank money settlement, with CeBM payments supported by the PBOC's China National Advanced Payments System. Settlement is typically T+0, although next-day settlement is permitted.

In October 2018, the central bank granted permission for the CDCC and SHCH to offer triparty collateral management services — which went live at SHCH in October 2018 and at CDCC in April 2019 — with potential for custodian banks to offer triparty collateral management services at a later time. However, triparty volumes are currently reported to be "insignificant" since the launch of these services (p 7).

SHCH has also proposed a GC financing facility involving its CCP and its triparty collateral management service (similar to the GCF service in the US, €GCPlus and GC Pooling in the EU and £GC in the UK). However, again, there has been little significant financing activity against GC baskets through this channel.

For repos traded on the exchanges, clearing and settlement takes place on the China Securities Depository and Clearing Corporation (CSDC, or Chinaclear), which supports T+1 settlement against commercial bank money payment. For repo trades executed on the stock exchanges (but not for OTC repos reported after execution to the exchanges), CSDC offers a CCP service to counterparties trading standardised repo against AAA-rated bonds.

This provides guaranteed settlement and anonymity to the counterparties, Comotto notes, but does not align with the CPMI/IOSCO's Principles for Financial Market Infrastructures. CSDC also provides triparty collateral management services to both exchanges, including automatic collateral allocation.

"This again shows evidence that China's financial authorities are committed to developing a post-trade infrastructure, including clearing services, that mirror the architecture employed in international capital markets," says Comotto. "However, I do not anticipate significant take-up of these central clearing services for repo market trades in the near term. Fundamentally, CCPs require volume in standard easily-nettable products. Whereas the US and European markets have electronic platforms supporting high trading volumes in short-term government bond repo, this trade flow does not currently exist in China's domestic repo marketplace. In the Interbank market, a major share of business is bank-to-customer and therefore unlikely to drive significant volume through the central clearing solution established by SCHC."

Concluding thoughts

In concluding, Richard Comotto highlights the important role that the Interbank Market has played since its inception in 1997 in supporting the central bank's move towards an interest rate-based monetary policy framework. This has facilitated the People's Bank of China's move from quantitative credit targets and direct interest rate guidance towards a monetary framework guided by daily open market intervention, reserve averaging, standing facilities and strategic policy signals.

Comotto notes that an efficient repo market provides a secure medium for open market operations, while repo rates provide an accurate indicator of the cost of wholesale funding, providing an effective benchmark for pricing risk and short-term financial assets.

China's desire to be integrated more fully into the international financial system, and to play a more prominent role in this system, is likely to prompt reforms to address some of the obstacles to development identified in this article. "Reforms to China's bankruptcy law will be an important starting point," notes Comotto. "If the financial authorities can encourage the development of a title transfer repo, supported by a robust bankruptcy law that protects collateral rights and netting against the insolvency regime, this would be a major step forward."

From a market structure perspective, he notes that China would benefit from promoting the development of a true dealer-to-dealer market, rather than the predominantly bank-to-customer arrangements that dominate the Interbank Market currently, where a wide range of trading entities are invited to participate.

These will be the key steps in developing a repo market that supports the wider development of China's financial markets and economy. "The People's Bank of China is fully aware of the importance of these reforms and progress will be dependent on whether political decision-makers will be willing to follow through with these changes, preparing the foundation for the next phase of China's repo market development," concludes Comotto.

A bright future in finance

Yuka Hasumi, head of EquiLend Japan, speaks to Carmella Haswell on the firm's plan to transform the securities lending space through its 1Source initiative, the varying pace of change for regulation globally and trading opportunities

As we continue into 2023, how would you assess EquiLend's securities lending programme performance in APAC so far? What trends and opportunities do you predict for the year?

For EquiLend, 2021 was one for the record books in terms of our Next Generation Trading (NGT) platform, despite having faced the COVID-19 pandemic. This was predominantly the result of global market volatility encouraging an uptick in clients using our NGT platform. This positive trend carried into 2022 — the year overall was very positive and extremely active for EquiLend.

The total trades we saw globally for 2022 increased by 10 per cent, when compared to an already high number of trades in 2021. When focusing on APAC — Japan being one of the biggest active markets in the region — EquiLend saw a year-on-year increase of 19 per cent in trading volumes for 2022 overall. The same theme of market volatility continued into 2022, which drove securities finance market volumes globally and regionally.

2022 was a really tough year, with global issues permeating through the financial landscape, in terms of the levels of inflation that impacted all global markets, the war in Ukraine and political uncertainty. We have seen different trends in demand and in the squeezes that we saw in the securities lending industry, which was reflected in NGT platform activity.

Looking ahead, there is considerable focus on non-general collateral (GC) execution and bringing other trade types onto the platform for greater efficiency, with a focus on high-touch and high-alpha trading opportunities. For instance, NGT's targeted availability provides a great way to handle specials while still leveraging the efficiency of automation through EquiLend. There is an increased interest in bond lending markets, as well as capturing more participants from markets such as Taiwan, South Korea and the like, as a large portion of these trades are not yet automated.

We are looking to continue to invest in platform improvements to reflect that trading behaviour and the appetite that we have been seeing from the community, as well as to encourage more automation and straight-through processing (STP) across all trade types. One of the enhancements that EquiLend is releasing globally in supporting that growth is our latest launch, Competitive Bid, as part of NGT, a purpose-built hard-to-borrow marketplace.

EquiLend unveiled its 1Source initiative in July 2022. What trends are you seeing in the DLT space in APAC? How are high levels of interconnectivity being provided across Asia?

1Source is currently in the design phase. We are working with key market participants as a joint initiative. For EquiLend, 1Source will be key to demonstrating our strength in innovation, interoperability and emphasising our longstanding client-first approach. Together, this allows us to help transform the securities finance space. 1Source is there to help eradicate reconciliation challenges by providing access to a "single source of truth" using distributed ledger technology (DLT). Increasingly, market participants are looking for technology which is more innovative, scalable and that solves the significant issues that everybody deals with on a daily basis.

From a client's perspective, the decision to adopt innovation may still require a very thorough analysis. What we have been hearing is that DLT is regarded as a foundational technology that I think has potential to create new foundations for the global securities finance space today.

It is still early days from an APAC perspective. A number of people still have questions about what DLT is. Everybody is going to face headwinds when it comes to new technology and APAC will learn from other regions in this space.

In APAC, participants feel a priority to promote technology adoption to boost efficiency and generate greater revenue streams. I hope it is a key message that APAC participants feel is needed to accelerate that innovation and meet the highest benchmark for greater operational efficiency.

The industry is continuously reviewing the relevance of ESG principles to securities lending programmes. How is the relationship between ESG and securities lending progressing in APAC and what concerns do people face if integrating the two?

Environmental, social and governance (ESG) continues to hit the headlines and present challenges for all vendors and clients across the globe. However, the opportunities are greater by leveraging a variety of technology capabilities and strategy to create business opportunities.

We are working with the market to make it more efficient to comply with ESG principles. For instance, we introduced an additional protocol that provides to lenders the ability to quote a callable date upon execution of a trade over the NGT platform. It allows brokers to be made aware of upcoming events such as annual general meetings (AGM) or extraordinary general meetings (EGM). There are firms which are very ESG aware and want to recall a stock that lacks governance around ESG. Globally, ESG is becoming increasingly imperative.

EquiLend rolled this protocol out to reach more firms in Japan as we found that there is an appetite from onshore online securities brokers, in particular, for us to help support that functionality. It is applicable for global custodians as well, for them to comply with the underlying fund ESG requirements.

While ESG is highly important and is a large focus for clients globally, it is not a simple process to benchmark firms across all three ESG criterias. For example, there is the often-cited example of Tesla being booted out of the S&P 500 ESG Index for lack of ESG credentials.

ESG is more complex than people had initially thought. Last year, EquiLend launched an ESG Data Analysis and Validation service for securities finance market participants to address a clear industry need for higher-quality ESG validation options, to help the market in achieving their ESG goals. ESG is a journey that will be ongoing for some time, EquiLend is here to support the market throughout this time.

Which regulatory changes is EquiLend most focused on this year?

EquiLend is regulated in every region that we operate in. We formed a regulatory technology solutions division called RegTech Solutions, headed up by Kevin McNulty, to create dedicated support for clients in fulfilling their regulatory requirements, regardless of the region that they operate in.

Regulation will continue to challenge market participants and vendors, with each regulation being

“While ESG is highly important and is a large focus for clients globally, it is not a simple process to benchmark firms across all three ESG criterias”

Yuka Hasumi
Head of EquiLend Japan
EquiLend

so nuanced and complex. We all need to be prepared for the impact of such changes by adopting the best solution, technology or products to remain compliant.

EquiLend has a long track record of deploying regulatory solutions around Securities Financing Transactions Regulation (SFTR), Central Securities Depositories Regulation (CSDR) and Agency Lender Disclosure (ALD). These have been some of the most significant regulations that our clients have had to comply with over the years.

CSDR recently celebrated one year since the enactment of the settlement discipline regime. We launched the Settlement Monitor tool ahead of CSDR, a solution that is dedicated to tracking, reconciling and resolving pending and failed securities finance transactions. The benefits that it has provided for our clients, year-to-date, are pretty dramatic. There were significant cost savings and an increase in automation of returns as well, which saw a 25 per cent increase YoY from 2021.

The pace of change for the regulatory landscape varies significantly from market to market. In Taiwan, for example, regulators rolled out consecutive short-selling rules within three weeks in October 2022. On the other hand, Australia and Japan are more akin to the US or EMEA, where there is a very long flight path of deliverance of a regulation. Taking the U.S. Securities and Exchange Commission's (SEC's) 10c-1 proposal as an example, the proposed rule was announced in 2021 and is yet to be finalised. However, EquiLend is ready to support it the moment it goes live.

We are putting substantial effort into ensuring that we can continue to work in each region to prepare for any new regulations that may be on the horizon, and to help our clients do the same.

It has been four years since the Japan-based Government Pension Investment Fund (GPIF) announced its stock lending suspension. Looking back, how has the move impacted the securities lending sector and what has the industry learnt from this?

I'm sure it was not an easy decision for GPIF, as the fund reportedly generated significant revenue from securities lending activity.

I think there was a short-term impact, but this was predominantly in markets where GPIF's holdings were very active— in the European and US markets for example. The event has made market participants realise that there is a large universe of beneficial owners and possible lenders out there.

The landscape has changed so much within securities lending in the past three years, it would be quite interesting to see what impact GPIF could have if it came back to the market.

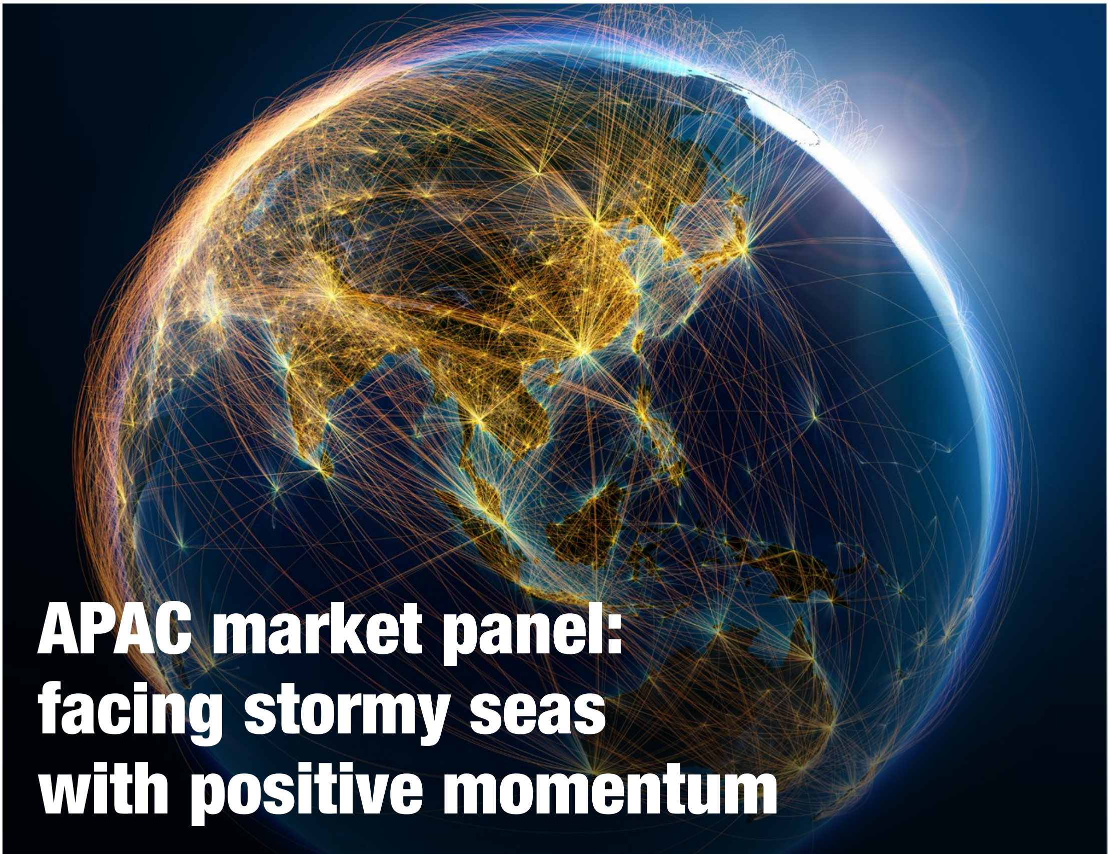
How is EquiLend further developing its securities lending solutions in 2023?

For EquiLend, the big focus at the moment is on digital transformation, specifically with the 1Source initiative. DLT definitely has a bright future in finance and within the securities finance space as well. The current global economic landscape may present a short-term setback in terms of technological advancement throughout the market, but, ultimately, it should help to accelerate the upcoming innovations that everybody has been talking about to meet the benchmarks of operational efficiency.

All market participants, in different ways and at different levels, are facing digital transformation, and EquiLend has continued to dedicate more resources and effort to this area. I think we are in a very exciting position right now and we continue to look ahead for new opportunities.

Another priority for us this year is the continued deployment of EquiLend Spire, which is a robust securities finance platform that powers a client's entire business. We are dedicated to working with our current and future EquiLend Spire clients to upgrade legacy systems to EquiLend Spire's state-of-the-art technology.

1Source and EquiLend Spire are just two of our areas of focus in 2023 and beyond. We are proud of our longstanding commitment to developing a more efficient securities finance marketplace globally, with continued innovation across our full ecosystem of trading, post-trade, data and analytics, regulatory technology and platform solutions.



APAC market panel: facing stormy seas with positive momentum

Panellists evaluate the performance of Asia's securities lending markets during 2022, new market opportunities in the APAC region and where the drivers of growth will be found during the year ahead

Panellists

Phil Garrett
Head of securities finance, Asia Pacific, Northern Trust

Jansen Chua
Senior vice president, head of securities finance, APAC, State Street

Natalie Floate
APAC head of market and financing services, securities services, BNP Paribas

David Lai
Product Manager, agency securities lending, Asia Pacific, J.P. Morgan

Phian Cheung
APAC desk manager, director of securities finance, BNY Mellon

How do you assess the performance of APAC securities lending markets during 2022?

Jansen Chua: 2022 was a difficult year for the markets, including securities lending activity. Despite a slew of macro headwinds, APAC's equity lending portfolios modestly beat expectations. A strong contribution from Australia and Taiwan specials lending offset softer Korea and Hong Kong markets. Fixed income lending activity also benefited from a widening of cross currency basis between the US and Australian dollar against the Japanese yen, driven by divergent central bank interest rate policies.

Natalie Floate: Globally, everyone looks at Asia Pacific for high fee levels, new market developments and new lending supply. 2022 did not disappoint in that regard, but it was not as strong as previous years in all areas. We saw increasing activity on the revenue side, with trade opportunities in the usual corporate activity with specials in Hong Kong, but we also saw increased use of Asian-issued government debt as collateral.

On the supply side, we identified new lenders entering the market and a renewed interest — post-COVID 'pauses' — to assess and enter the market, or to understand the barriers to entry and potential revenues. The focus on collateral needs has been a key trend — with securities lending being used to source liquidity or collateral, or to generate additional revenue for those long of HQLA.

Phil Garrett: It has been a challenging year across APAC in many respects. But there were also pockets of strong performance during 2022. The macroeconomic headwinds felt globally were compounded regionally by prolonged COVID-19 restrictions and regulatory tightening. The traditionally strong revenue markets of Japan and Hong Kong suffered from a dearth of event activity, including mergers and acquisitions, rights issues, placements and convertible bonds issuance, which are typical drivers of high fee trading strategies. Falling stock market valuations also adversely impacted revenue generation, with most indices tracking down in the 15-20 per cent range over the year. In addition, we saw a de-grossing of hedge fund exposures across the region.

On the positive side, some markets performed strongly — including Australia, boosted by the BHP Group listing consolidation, where revenues were up more than 50 per cent year-on-year. Taiwan revenues increased by approximately 20 per cent relative to 2021, driven by strong demand generated through short exposures to its tech-heavy index. The performance of these two markets and the fact that there was a full year of short selling activity in Korea — in contrast to 2021, where the short-sell ban was only partially lifted in May of that year — meant that overall APAC performance was relatively flat year-on-year.

David Lai: Throughout 2022, the APAC region saw a normalisation of lending activities across most markets and asset classes, with Australia, in particular, providing a plethora of opportunities for outperformance across both equities and fixed income lending.

This was driven by increased corporate event activity and strong directional flows within the equities space, alongside the Australian Government's Quantitative easing (QE) monetary bond buying programme within the fixed income sphere. The Australian QE programme led to a reduction of fixed income assets in the repo markets — with assets that remained available to trade being highly sought-after — which provided support for funding activity at optimal levels.

Elsewhere in the region, the South Korean and Taiwanese markets continued to excel, offering high spread lending opportunities consistently throughout the year, inspite of the implementation of differing short sell measures by the respective regulators.

A high-volume, low-spread environment was sustained by the Japanese equities lending market in 2022, continuing the theme seen in preceding years — although intermittently interrupted by directional flows within specific sectors. Japanese fixed income lending also afforded additional opportunities for market participants to enhance their lending performance.

The Hong Kong market reacted negatively to ongoing pandemic restrictions during 2022, with pessimistic investor sentiments presenting challenges and impacting lending flows. Performance improved in

Q4, with Hong Kong lending participants witnessing a recovery as the year concluded, setting the stage for a positive start to 2023.

Phian Cheung: APAC securities lending markets had a good 2022. Revenue numbers were some of the highest in recent years, although not as high as in 2018 when borrowing demand and volatility surged on the big dive after the longest bull run in history. Hong Kong, Japan and Taiwan were the top three markets in terms of revenue generation. Hong Kong, which has 50 per cent of the top 10 names in the region, enjoyed the highest average spread in five years at 1.27 per cent. Top specials included developers, healthcare, technology and restaurant chains, driven by China's regulatory crackdown and COVID-zero policy over the year. The top Hong Kong borrow was Tianneng power, which has generated fund interest since 2020.

The top Asia special in 2022 was BHP in Australia, which unified its corporate structure at the beginning of the year. The name was also one of the top 10 specials in 2021, following the launch of its 'unification' or listing structure proposal. Revenues in 2022 for APAC were fairly consistent on a quarterly basis. Hong Kong dominated more in Q3 (contributing to 30 per cent of APAC's number) due to the China property crisis and the slide in China technology and growth stocks. Japan contributed an estimated 21-25 per cent, Taiwan delivered 19-24 per cent, South Korea 13-17 per cent and Australia 11-12 per cent, across quarters.

One clear observation over the years has been that individual specials have contributed less to the overall revenue number and revenue sources have become more diversified. The percentage share of the top 25 and five 'specials' contribution to yearly revenue has come down from 35.83 per cent and 13.88 per cent respectively in 2019 to 19.48 per cent and 5.34 per cent in 2022. While a big special in the past (for example, Celltrion in 2018) might have contributed US$85 million on one single name, the sum of revenue brought by the top 10 specials together in 2022 was near to US$86 million. Shown another way, top specials generated between US$6-26 million each in 2021-22 versus US$10-85 million each in 2018-19.

With the Federal Reserve hiking interest rates aggressively and creating volatility around markets, there was also an uptick in demand, spread and revenue from Australia government bonds and EM Asian government bonds. Demand for Australia government bonds, in particular, picked up in Q2 and Q3 owing to bond market volatility and market dislocation driven by the Reserve Bank of Australia's (RBA's) prior yield-control strategy. UST versus JGB remained the biggest bond transformation trade globally, with strong demand from APAC.

In which APAC markets do you identify new opportunities for growth of your lending business during 2023?

"One clear observation over the years has been that individual specials have contributed less to the overall revenue number and revenue sources have become more diversified"

Phian Cheung
APAC desk manager, director of securities finance
BNY Mellon

Chua: We believe Taiwan remains an attractive market for SBL activity, given the current low active foreign beneficial owner participation. The regulators took action in 2022 to limit short selling activity, but this did not have a significant impact on market opportunities and, as such, we see a significant upside for owners to expand their activity in this space.

Korea is another market that we are tracking closely. Recent announcements to replace or remove the current IRC construct by the second half of 2023 could translate into significant operational efficiencies for lending activity and end-investors alike — in turn, driving higher performance and returns.

Garrett: We expect to see growth resulting from continued regulatory pressures on balance sheets, the hunt for alpha and the need to optimise long holdings through funding trades. For APAC, this will provide opportunities for lenders that are able to accept expanded collateral types such as Korean treasury bonds, Korean equities and Stock Connect equities.

Development of APAC's securities lending markets will continue with measured progress, whether it is the enhancement of the China and India models or the implementation of offshore platforms in the Philippines, Indonesia and Vietnam. However, we do not expect developments in these markets to present material opportunities in 2023.

Lai: The implementation of the framework to support securities lending by offshore participants in the China, Philippines and Indonesian markets is always front of mind for us as we refine and develop our APAC strategy. Financial regulators have introduced a range of positive developments in these markets. We remain optimistic that the ongoing industry engagement and regulatory changes will yield positive results in future years.

General themes — with respect to collateral optimisation, digitalisation and the ability to provide bespoke solutions to our clients — drive the investment and strategy of our wider trading services business. Our teams of multi-asset traders, our unique ASF financing solutions team and our triparty business, ensure that we are always at the forefront of introducing new products to the market, thereby increasing our APAC footprint strategically to monetise growth opportunities as and when it is appropriate.

Which regulatory initiatives in APAC markets will consume most attention for your agency lending and collateral management teams over the coming 12 months? What programmes are ongoing within PASLA, and at industry-level more broadly, to support this change agenda?

Garrett: Taiwan and Korea will be prominent in our regulatory focus. Taiwan reduced its short-sell quota from 30 per cent of 30-day average daily volume to 20 per cent, and then 10 per cent in October. While this did not have an immediate impact on lending performance, a prolonged period of reduced quota may be detrimental through 2023.

In Korea, disappointingly, we did not see the anticipated lifting of the remaining short-sell ban in 2023. As it stands, short selling can still only occur for KOSPI200 and KOSDAQ15 constituents, providing limited opportunity for market participants. The enhanced regulatory reporting, oversight and enforcement regime, while well intended, creates an additional burden and risk for borrowers which is likely to play a critical part in any decision pertaining to participating in the Korean market. This does not bode well for demand for Korea heading into 2023 and we expect revenue opportunities from this market to remain suppressed.

Northern Trust is an active member of the PASLA board and within its working groups. The working groups cover all the APAC markets, engaging with regulators and regional stock exchanges to promote the development and enhancement of securities lending across the region.

Chua: We are expecting to work closely with PASLA and ASIFMA over the next 12 months on the further liberalisation of the Chinese markets. Adoption of proposed recommendations and structural changes could help ignite SBL activity within the HK-Stock

Connect framework, which would further provide benefits in terms of improved market resilience and financial stability.

The proposed change to T+1 for US equity markets, while not strictly related to APAC, will have an impact on agent lenders and APAC beneficial owners, particularly those with US equity lending programmes. Changes to investment management operating models (such as trade capture timings, instruction routing and information dissemination) and SBL processing (such as trade inputs, recall processing) are likely to be necessary in order to ensure compliance.

Finally, we also expect to be engaged with PASLA regarding Indonesia and the Philippines, following up with the relevant authorities on the positive strides made by both jurisdictions in 2022 to open up securities financing markets.

Cheung: Balance sheet management has never been more important to the securities lending industry, including for agency lenders as balance sheets of major prime broker borrowers have been greatly strained in past years. The cost of indemnification and other Comprehensive Capital Analysis and Review (CCAR) issues from agency lenders are resulting in the need for detailed and proactive capital planning.

The increase in high-quality capital to risk-weighted assets (RWA) of financial companies — a priority since the inception of CCAR in 2009 — has been growing over the years. This has created incredible funding trade opportunities for lenders. The focus of RWA has also driven borrowers to shift balances to lenders that can offer decent amounts of inventory via low RWA funds.

This trend has continued in 2022. In response, banks have been working on creating innovative solutions for RWA buckets, automating consistent CCAR processes and frameworks, as well as building seamless risk-model architecture. They will require more resources and talent to improve in 2023 and beyond. The ability to navigate CCAR challenges and apply capital efficiently will, to a greater extent, differentiate the winners and losers across the industry.

From a lender's perspective, competitive margins and greater investments in technology and infrastructure changes regionally resulted in flows channelled to a reduced number of prime broker borrowers. For brokers, the landscape has evolved in the last couple of years — each concentrating on its own niche, be it ASEAN markets, Taiwan-specific execution or funding. On the lender side, if fewer brokers borrow securities, certain conservative restrictions on loan concentration leads to undesired ratios such as the single counterparty credit limit (SCCL), which in turn can impact daily business.

The cost of capital has also driven some agents to move up their GC rates to optimise return on capital. With all the challenges banks are facing on RWA and SCCL constraints, solutions have emerged such as agency prime brokerage, which connects buy-side lenders to buy-side borrowers through prime brokers, or peer-to-peer lending, which similarly connects buy-side participants directly via technology.

Agency SWAPs — SWAP access for prime brokers or borrowers hedged via buy-side inventory positions — managed by an agent lender, has also become more important. The industry anticipates further developments. To stay relevant in the new normal, intermediaries will continue to come up with creative solutions.

What investments and adaptations to technology and working practices have you made during 2022 to sustain and grow your securities lending activity in the Asia-Pacific region?

Lai: At J.P. Morgan, we believe our firm-wide technology budget is unrivalled in the industry, with more than US$14 billion allocated across our technology programme in 2022. While our underlying clients are direct beneficiaries of shared investment funds across the firm, for our securities services lines of business, technology investment has increased 40 per cent since 2016.

This investment has enabled the integration of our securities finance, collateral management and triparty services, allowing us to offer new collateral mobilisation and optimisation tools to our clients, helping to minimise the impact of increased margin requirements on financing revenue.

Investments have been made in support of growing demand for non-custody lending, as more beneficial owners take a 'best of breed' approach to agent selection, to providing a flexible approach to indemnification and facilitating direct financing transactions.

Empowering our clients to 'self-serve' has been a continuing theme. While there has been a focus on modernisation and security — for example, greater use of our portal as opposed to emails — we have also concentrated on other important aspects such as data integration — leveraging across our multiple product offerings to bring more product related information together — and interoperability — streamlining across various applications.

Floate: We have been working on our global model for all developments. However, ensuring that functionalities, feeds and reporting work consistently from the US to Australia and New Zealand time-zones has been a key consideration for us. One example of this has been our trading overlay, which allows our traders, located at a desk anywhere in the world, to lend a local asset regardless of where the beneficial owner of that asset, or the account it resides in, is located.

We have also been focusing on settlement efficiency. It may sound a little boring, but we are in an environment where settlement cycles continue to contract. Consequently, it is essential to continue to improve operational efficiency to minimise the prospects of settlement fails or late matching.

Cheung: Automation of manual processes — for example, via Pirum and auto-borrow trading — remains a fundamental focus of most banks and market participants. Tighter lending settlement practices are here to stay as squeezes around efficiencies, regulation and fears of penalties bite. Taiwan is already a no-fail market. Korean authorities have upped the ante when it comes to short-sell penalties for any rule-breakers. If, or when, China opens its SBL market to offshore participants, a same-day settlement market awaits. Therefore, we are investing proactively in scaled solutions.

At BNY Mellon, we are focused on connecting the dots across our businesses to ensure that clients can take advantage of our services across liquidity, IM segregation, collateral optimisation, treasury services and FX. We are also committed to our people. Giving staff flexibility around work location has been key to our resiliency throughout the past three years. It has also been a game-changer in terms of both talent retention and attraction. A happy staff ultimately feeds through to happy clients and a culture of trust and resiliency.

Garrett: Our clients are facing growing demands on

"We are in an environment where settlement cycles continue to contract. It is essential to continue to improve operational efficiency to minimise the prospects of settlement fails or late matching"

Natalie Floate
APAC head of market and financing services, securities services
BNP Paribas

their assets as they seek to cover increasingly complex margin requirements, while remaining compliant with global regulatory challenges. At the same time, they are looking to minimise the impact of these challenges on overall performance. Northern Trust is working on a solution to help clients manage this complexity and drive efficiencies. Alongside Northern Trust's existing capabilities, we are pursuing the development of an integrated inventory management platform solution that would serve as the single point of interface across collateral management, financing and liquidity, as well as securities lending and borrowing.

Chua: We continue to invest in a multi-year re-platforming exercise for our proprietary securities financing platform and this effort has started to deliver efficiencies in 2022. We anticipate further opportunities to improve our offering in 2023 as roll-outs of new functions gather pace.

State Street also launched Venturi in 2022. Venturi is a peer-to-peer financing platform designed to connect buy-side firms with new sources of liquidity in the global repo space. Built through our partnership with FinOptSys, Venturi supports trade negotiation and enhances trade settlement and collateral management. In helping to centralise liquidity and enhance transparency, we believe Venturi will help clients to open up new trading opportunities, lower transaction costs and improve returns.

How have monetary conditions shaped post-pandemic securities lending opportunities in the Japanese market?

How are you positioning yourself to maximise opportunities for lenders and borrowers in this environment?

Lai: Japan is of strategic importance for the wider J.P. Morgan Securities Services franchise. We opened our agency securities finance trading desk in Tokyo in December 2021 and now clients can access the full suite of our trading services through our Japan team. Our ongoing investment in people and across our onshore platform allows us to bring our market-leading global product offerings and services, overlaid and refined by local expertise, to borrowers and lenders in the Japanese market. This local experience ensures that we are well-positioned to navigate market conditions more efficiently and provides a framework to deliver local market solutions that better support the nuances and needs of the Japanese market.

Garrett: Loose monetary policy in Japan, as well as rising interest rates set by the US Federal Open Market Committee, led to a further widening of the cross-currency basis spread between the US dollar and Japanese yen in 2022. Clients that were able to lend US treasuries against JGB collateral were able to benefit from the arbitrage opportunity. This strategy was given a jolt in December 2022 when the Bank of

"There are good reasons to be optimistic. We expect to see a marked increase in trading opportunities within APAC as the drag on the performance, seen through 2022, eases"

Phil Garrett
Head of securities finance, Asia Pacific
Northern Trust

Japan announced a surprising increase to its 10-year bond yield cap to 0.5 per cent, which initially saw the basis narrow for several days before widening again. The ability to balance exposures between overnight and term trades is key to optimising returns in the face of potential future surprises from central banks.

Cheung: Central banks, including the Bank of Japan, are facing the difficult challenge of scaling back bond-purchase programmes without creating market turmoil. Inflationary pressures in the developed world, created by the liquidity from expanded balance sheets, were further intensified by supply chain disruptions, labour market shortages and the energy crisis. Japan's core inflation recently exceeded the BoJ's 2 per cent target and hit a 41-year high. The BoJ surprised markets in December by raising the upper limit of its tolerance band on 10-year government bonds to 0.5 per cent from 0.25 per cent, though it kept its ultra-low benchmark interest rates unchanged.

The magnitude of QE in Japan, relative to the overall economy, has been much larger compared to other developed countries. Moreover, the range of assets purchased— including corporate bonds, ETFs and equities —has been much broader. All of this suggests that market volatility is likely to follow once the BoJ starts to reduce its balance sheet and, consequently, liquidity in the financial system declines. However, increased market volatility will create opportunities for the lending business.

The recent selloff in global bond markets has pushed the 10-year JGB yield to the upper limit of the BoJ's range, forcing the BoJ to execute more bond purchases into the end of last year to defend its cap. The indirect impact on the SBL market would be the reduction of JGB supply in the market. Market functioning and liquidity have deteriorated with the BoJ's increasing presence in the bond market and its massive JGB purchases; this made it slightly more expensive to source JGBs for different types of funding trades.

Lenders and borrowers will need to manage inventory well to tackle potential volatility in JGBs. Maximising opportunities in pricing and trading JGBs correctly is one thing, but increasing collateral diversity away from JGBs when borrowing and lending UST or HQLA may be necessary. Ultimately, sourcing JGB collateral might not be as swift and as easy in future with the BoJ's proactive action.

Chua: Post-pandemic global inflation and interest rate divergence has driven a widening of the cross currency basis spread (in particular US$ and AU$ versus JPY). This has provided a strong revenue opportunity through 2022 for fixed income portfolios. We believe this will continue into 2023. The likelihood of higher interest rates in Japan should also present more opportunities for equity borrowing and fixed income lending. Expanding State Street's longstanding market leading capabilities in yen cash collateral will be a focus for

"Expanding State Street's longstanding market-leading capabilities in yen cash collateral will be a focus for 2023, as well as further developing JGB trading to position for future opportunities"

Jansen Chua
Senior vice president, head of securities finance, APAC
State Street

2023, as well as further developing JGB trading to position for future opportunities.

In December 2020, Chinese regulatory authorities expanded the scope of products available to those who had a Qualified Foreign Institutional Investor (QFII) licence to include securities lending and short selling, among other amendments.

How do you assess potential for growth of securities lending activity in the Chinese market?

Garrett: The potential for growth in the Chinese market through physical securities lending remains extremely compelling. However, the current operating models offered through Stock Connect or QFII still present idiosyncratic challenges. The most obvious hurdle for the offshore lending community is the lack of inclusion of agent lenders in the regulatory frameworks. Without the infrastructure and expertise provided by an agent lender, it would be extremely challenging for beneficial owners to access those platforms.

For the QFII model in particular, many challenges persist for both agent lenders (fixed fees and tenors on the main board, collateral retained at the CCP, untested default process) and for borrowers (uptick rules, onerous margin requirements, short settlement cycles). To address these issues, industry engagement with regulators through associations like PASLA and ASIFMA is of paramount importance. In 2023, the post-pandemic easing of travel into mainland China will be beneficial to this goal.

Lai: We would note other positive related announcements — for example, notices regarding insurance funds participating in securities lending markets. From a J.P. Morgan perspective, this has facilitated more dialogue internally and externally and we are excited about this workstream. The potential for growth of securities lending activity in the Chinese market is unprecedented. China simply cannot be overlooked.

While the benefits of Chinese shares being included in various global indices have been previously discussed, the Chinese market stands poised to benefit from the expected increased liquidity that will flow to the region this year. Without revisiting previous articles and material, I expect the industry to remain focused in this space, with the initial priority once again to look at the role that an agent lender can play in this process.

What expectations do your APAC clients have from you as a service provider in supporting their commitment to sustainable lending and borrowing?

Chua: ESG-compliant solutions for securities lending activity remains a topic of interest among clients, but no clear agreement has emerged around

“The potential for growth of securities lending activity in the Chinese market is unprecedented. China simply cannot be overlooked”

David Lai
Product Manager, Agency Securities Lending, Asia Pacific,
J.P. Morgan

implementation or compliance. Current ideas revolve around proxy voting, collateral eligibility and cash reinvestment guidelines.

Floate: This topic has mainly been relevant for our buy-side lending clients that have mature ESG principles implemented across their core investment portfolios. They view securities lending as an ancillary activity and look to us, acting as their agent, for two things.

Firstly, to ensure that we meet their core objectives — for example, not accepting a security that does not meet the ESG criteria of their main investment portfolio as collateral. Secondly, to provide them with elements of ESG adherence that only we can implement as their agent. For instance, ensuring a proper recall mechanism is in place to enable them to exercise proper governance and vote at key general meetings.

Lai: J.P. Morgan Agency Securities Finance remains fully committed to serving our global clients in all aspects of their securities lending programme. In terms of sustainability, our approach centres on the provision and use of various tools to define individual requirements and outline a tailored programme. For instance, in the concept of proxy voting, our platform offers clients the ability to set requirements based on criteria such as meeting type, market and asset type.

In terms of non-cash collateral, clients are provided with multiple levels of eligibility restrictions. Our continuing investments in our technology platform helps us to support our client's ESG requirements. It would be presumptive on our part to believe that recent market conditions and geopolitical stresses have not had some impact on the demand for ESG-compliant lending solutions. The material in the public domain is a testament to this. The offerings we provide at J.P. Morgan reflects the diverse nature of our global client base.

How do you assess the outlook for APAC securities lending markets for 2023?

Cheung: We see a great opportunity for Hong Kong in 2023 in an improved macro environment, after its links with the mainland were re-established on the border reopening on 8 January this year. We think the Hong Kong IPO market will perform strongly in 2023, with positive momentum from the beginning of the year and signs that the technology crackdown is coming to an end. A revival in IPOs and placements in Hong Kong will be helpful to the growth of the lending business this year.

China's reopening would also help export-driven North Asia, especially technology names that have China exposure. South Korea and Taiwan, for example, have a reputation as "early-cycle" leaders in a demand recovery. Some of the semiconductor names are already up 10 per cent year-to-date. Volatility around capacitors and semis will remain and SBL activity will still be active in Taiwan, like in 2022. Another Taiwan sector likely to remain in focus is shipping. Normalisation in global trade could bring inflated revenue for the sector back to normal. Geopolitical risk related to Taiwan would surely add instability to the market.

Given the current pace of Fed rate hikes, the strong US dollar and the massive capital outflow in 2022, it might take some time for emerging markets to stabilise. Consequently, EM regulators might not lift their short-sell bans and restrictions completely in the first half of the year. However, we do see a chance of that happening in the second half of the year when markets stabilise. Brokers perceive South Korean stocks to be the top "rebound candidate", given their low valuations. Given the bumpy road ahead, we believe market flows in the securities finance space will be active.

With brokers shifting their borrowing needs to synthetic business with lower balance sheet constraints, and with the internalisation of prime brokers' own books, markets like Japan and Australia have not been as active in the physical borrowing space. While seasonal names still generated volatility and borrow activities across Japan, specials activity in Japan has become less and less. None of the top-10 ranked APAC specials included a Japanese name in 2022 and 2021, whereas Japan occupied 30-40 per cent of the top names in previous years.

The lack of specials borrowing in the physical markets is also illustrated by a reduction in the average fee for Japanese loans to around 47-52bps for the past few years, compared with more than 80bps in 2019. APAC markets are unlikely to see a meaningful revenue uptick in 2023 unless there is another big deal or corporate action event trade like BHP in Australia. As always, it is all about those specials!

Lai: APAC securities lending markets will almost certainly experience some headwinds in 2023. We are not immune to the slowing pace of growth globally and are likely to be impacted if markets appear to be heading into a recession. However, we do expect some to be outliers to this trend. China's reopening will help to boost market sentiments across the APAC region. We expect corporate earnings to increase in Hong Kong as the outlook for the economy improves. We also expect to see a resumption of IPOs and corporate activity, supporting a return to previous market performance as the city continues along its path to recovery.

There is speculation within Japan that the BOJ will shift its monetary policy in Q2 to counter inflation, while the declining USD and JPY exchange rate will continue to create opportunities across fixed income and equities. More generally, balance sheet optimisation will remain our focus in 2023, along with the development of more sophisticated solutions to support evolving client requirements in this space regionally and globally.

Chua: We are optimistic for growth in APAC SBL markets this year, driven by the reopening story in China and Hong Kong. The outlook for the Japanese economy and related equity finance activity will be heavily impacted by how the Bank of Japan adjusts monetary policy in 2023. We believe that cross-currency basis transactions will remain popular, although spreads will compress as interest rate divergence eases.

The Korea regulator has added resourcing and increased oversight cadence into SBL and short selling activity conducted by foreign banks and broker dealers. This greater intensity seems to demonstrate regulatory and political support for short selling, albeit with enhanced penalties and stronger safeguards. Any moves to loosen current short selling restrictions (currently limited to 350 issuers, imposed in 2020) is likely to strengthen demand and improve market returns in 2023.

As the opportunity cost for deploying cash increases with interest rates, we also expect the trend for non-cash collateral usage to continue. Lenders, on the other hand, will continue to demand high-quality collateral such as Australia government bonds, on top of the traditional cash, USTs and JGBS.

Garrett: Looking ahead, there are good reasons to be optimistic. We expect to see a marked increase in trading opportunities within APAC as the drag on the performance, seen through 2022, eases. China's easing of its Zero-COVID policy — and recent constructive political interaction signalling potential for de-escalation of the US-China trade war — could be positive for APAC stock markets which have already been buoyed by these developments. Counterintuitively, strong performing markets will allow for increased exposures on the short side, as well as the long side, as stock prices decorrelate.

The start of 2023 has seen several companies raising capital through secondary offerings, and this could bode well for event-driven lending activity in the region.

Floate: We identify a positive outlook for 2023! We are uniquely positioned in Asia Pacific, as we are in a region which still has a broad mix of developed and developing markets. We were recently reviewing a table of Asia Pacific market specificities for the upcoming training session of the PASLA conference (first day). We found that even those who have worked in the region for many years were struck by the market-to-market nuances and differences between regulations, reporting requirements, pre-trade requirements and exchange requirements.

With these differences, we have a broad mix of activities daily — for example, Hong Kong or Japanese equity trading that we know well, while also working to help open some of the lesser developed markets to securities lending. This latter element brings variety as we work with exchanges, regulators and tax offices and then with our internal product and functional teams to bring something new to the market. In my view, nothing beats doing a new type of trade for the first time in finance. ■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(1) RBC quarterly results as at October 31, 2022

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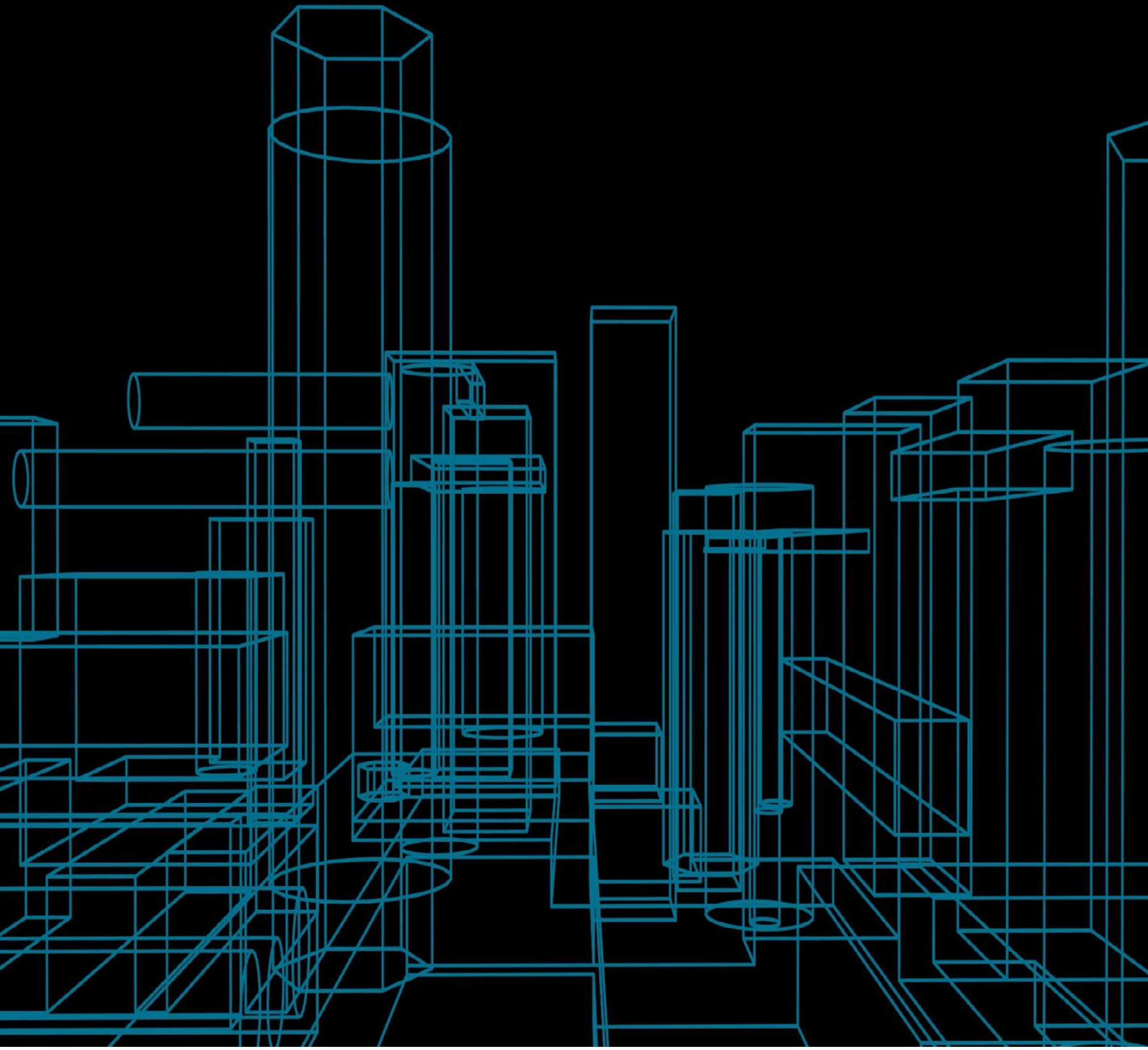

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