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The dash for growth in Asian securities lending

A tremendously diverse, highly dynamic and fiercely competitive region, Asia is no place for the faint of heart. Those seeking to secure a piece of the region's nascent securities-lending business must come armed with a thorough understanding of the regulatory nuances within each locale, and getting up to speed can be a considerable task. It is no surprise, then, that demand continues to outweigh supply in the region. David Simons reports.

GIVEN THE CONSERVATIVE tenor of their peers in Europe and the US in the wake of the financial crisis, not surprisingly Asian regulators have taken a cautious approach to the establishment of a securities-lending market. Still, lending services have been anything but sluggish in recent times; compared to their counterparts elsewhere, Asia's market participants are reasonably bullish about the prospects for growth. During 2011, lending revenues in Asia increased an estimated 25% year-over-year, and with a new year under way, countries such as Singapore, Hong Kong and Taiwan are expected to continue the upward trend in revenue generation. As sec-lending momentum builds, regulators have been working to stay one step ahead in an effort to discourage the kind of opacity that prevailed pre-crisis.

As regulation typically varies from one region to the next, the market for securities services within Asia is hardly a one-size-fits-all proposition. While a huge uptick in arbitrage opportunities within India's National Stock Exchange has fuelled sec-lending growth of late, in China

it is as much about future opportunities as the here and now. Whereas Japan has seen tremendous growth in corporate-bond activity, elsewhere demand has been relatively muted. Hence, the ability to understand the specific opportunities and intricacies within each locale has become compulsory for regional providers.

Lending leaders

While most emerging markets have strong potential for securities lending, BNY Mellon has been particularly focused on opportunities in the Far East, specifically markets such as Taiwan, Korea and Malaysia, where offshore supply continues to trail regional demand.

"We have offshore clients that have attractive positions and are ready to participate," says Rob Coxon, head of international lending, BNY Mellon Asset Servicing.

"The drivers for securities lending in Asia haven't really changed—hedge funds and their specific trading strategies are continuing to fuel borrowing demand," says Coxon. ►►



Robert Lees, Brown Brothers Harriman. "As Asia becomes increasingly relevant to the global economy and its capital markets mature, we expect to see increased opportunities for SBL growth across the region." Photograph kindly supplied by Brown Brothers Harriman, January 2012.

"We've seen many trades around recapitalisation during the past year. Regulatory and economic uncertainty does not help with the resulting volatility, but hedge funds are paid to work through these obstacles."

The Asian markets tend to rely on much more securities-lending specific regulations, and many of their structures revolve around a central counterparty and the requirement to report positions, particularly compared to the US and Europe. Accordingly, a different approach needs to be adopted as dictated to by the local regulator, and this often leads to additional cost, says Coxon.

What makes Asia particularly attractive from a lending perspective, says Robert Lees, head of trading for Asia Pacific, global securities lending at Brown Brothers Harriman, is the potential for significant growth in more established markets including Hong Kong and South Korea, as well as in nascent regions such as India and China that remain committed to developing their securities, borrowing and lending (SBL) frameworks. "As Asia becomes increasingly relevant to the global economy and its capital markets mature, we expect to see increased opportunities for SBL growth across the region," he says.

Event-driven and long-short strategies continue to pace regional activity, says Lees. "During the later part of 2011 we witnessed a significant uptick in markets like Hong Kong, as concerns around economic growth prevailed, corporate-accounting unease came to the fore, and sector-specific interest drove demand."

South Korea re-emerged as an investor target during 2011 after the country lifted its ban on short selling, and

Taiwan gained favour as well during the past year, despite certain restrictions placed on beneficial owners wishing to lend in that country. "The Taiwanese have taken a very practical approach to the securities finance market," says John Arnesen, head of agency lending at BNP Paribas Securities Services. "Business has been done in a very collaborative and transparent manner." A lack of supply in South Korea makes a compelling case for establishing one's capabilities within that country, adds Arnesen.

Though China holds the greatest potential for growth in the region, the establishment of an onshore market is still a way off, and investors must be patient, notes Arnesen. "When the market is finally developed, it is likely to be an exchange-based adoption of the service, using a central counterparty structure," he says.

Fundamentals are likely to remain strong in Asia for an indefinite period, however any uncertainty surrounding the evolving regulatory environment, such as an increased focus on capital controls or further restrictions on short-selling, could negatively impact both supply and demand, says Lees.

"The regulatory environment has been a key variable within the regional sec-lending business, with Asia's regulators generally taking a wait-and-see approach contingent on the effectiveness of policies in both Europe and America," says Lees. This has allowed local regulators to properly assess their own country's situation and develop a reasoned response. In many instances, only minor adjustments have been needed; some, like Hong Kong, Japan, and Singapore, have not made any major regulatory changes at all.

"Sub-custodians are increasingly called upon to play a larger role in liquidity management, including clearing and the managing of collateral, particularly as the markets continue to transition from OTC to CCP clearing."

"It is important to note that within Asia, markets are in different stages of securities borrowing and lending development, from fully established to frontier markets, so each market will have its own distinct rules and regulations," says Lees. "This places a much greater emphasis on understanding the overall market structure and requires firms to dedicate significant resources within the region to ensure they are involved in the regulatory conversation."

With Asia's securities-lending practices remaining highly restrictive, sub-custodians such as Standard Chartered Bank can often serve as a conduit in order to help investors gain access to a particular market, says Giles Elliott, head of product, investor and intermediaries for SCB. "Sub-custodians are increasingly called upon to play a larger role in liquidity management, including clearing and the managing of collateral, particularly as the markets continue to transition from OTC to CCP clearing."



John Arnesen, head of agency lending, BNP Paribas Securities Services. "When the market is finally developed, it is likely to be an exchange-based adoption of the service, using a central counterparty structure." Photograph kindly supplied by BNP Paribas, January 2012.

As beneficial owners seek plausible opportunities in Asia and elsewhere, they are more likely to be drawn to those areas with a strong regulatory policy. "The enactment of temporary short-sale restrictions, for example, would likely cause investors to 'trade away,'" says Lees. "In regions that have demonstrated a clear, consistent approach, however, investor confidence has been much higher."

In Asia, demand remains strong for structured and derivative-type products that require that the underlying equity be borrowed for hedging purposes. This bodes well for the region's securities finance business, says Arnesen. "For example, Hong Kong gives retail investors opportunities to enter the market from the short side, which in turn fuels the demand to borrow."

Compared to their counterparts in Europe and elsewhere, Asian regulators often take a more collaborative approach to working with the market in an effort to establish practical solutions. "Some of the negative perceptions of short selling in Europe for example, where politics appear to have entered the fray, do not emerge in Asia where a longer-term, more considered view prevails," offers Arnesen.

In the past, the custodial provider has typically served as the securities-lending agent essentially by default. However, in the wake of the financial crisis and an increased focus on counterparty risk, more beneficial owners are looking to use best-in-class providers, suggests Lees. This has led to increased unbundling of securities lending from the parent custodian, particularly within the

EU and the US. According to Lees, at present roughly 40% of BBH's lendable assets are currently derived from third-party sources. "Investors are seeking out customisation, diversification and transparency, and are increasingly taking different approaches to market—now more than ever there is room for specialised providers."

A bundled approach prevails

In Asia, the bundled approach remains the primary route to market, and is perhaps indicative of the region's relative stage of sec-lending development. "However, as beneficial owners strive for additional value in terms of revenue, enhanced risk management and transparency, we will likely witness a similar trend towards the selection of providers based on their merits rather than on a custodial or other relationship," suggests Lees.

According to Arnesen, unbundling in Asia is typically driven by the requirements of the beneficial owner and whether the model offered by the incumbent custodian can meet their needs, rather than the type of asset available for lending. Moreover, there may be very practical constraints in some markets, where operational considerations hamper the ability to deliver assets for lending purposes when instructed by a third party.

"As new sources of supply emerge in the region, it will be interesting to see whether that development leaps ahead of the evolution that took place in the West, whereby custodial lending was the primary route to market prior to the emergence of third-party lending within the past decade."

"As Asia becomes increasingly relevant to the global economy and its capital markets mature, we expect to see increased opportunities for SBL growth across the region."

Brian Lamb, chief executive officer of New York-based EquiLend, a provider of trading and operations services for the securities finance industry, agrees that the regulatory differences that exist within Asia have led to a much slower and more thoughtful approach to the development of a lending industry. "Hong Kong, for example, decided years ago that all lending transactions must occur on-exchange, which is something that is fairly unique on a global basis. The fact is that players in the region have been heavily influenced by what has been going on in the EU and the US. Hence, many have erred to the side of caution," he says.

Prudent though they may be, government leaders understand the link between securities finance and enhanced market efficiencies. "You need to have a fluid paradigm so that prices don't just move in one direction," says Lamb. "There's a feedback loop, if you will, that helps to keep that in check—and that is a major part of what financing and lending brings to any marketplace."

Can "over-regulation" cause participants to seek opportunities elsewhere? Case in point: just four years ago, ►►

Australia ranked third in global securities-lending activity. By 2009, however, the global-market unravelling had prompted the Australian Securities and Investments Commission (ASIC) to enact a nine-month ban on short selling, and since that time many of the country's regulatory measures have been among the toughest in the world—so much so that some managers have chosen to bypass the region altogether.

Not that those regulators are about to soften their stance because it might be good for business. Despite incessant

demand from outside investors, India refuses to embrace an over-the-counter model, while Japan, home to the world's second largest financing market, remains a sleeping giant. Experts like Lamb, however, believe that it is just a matter of time until many of these markets begin to open up, and are using this down time to prepare for the various opportunities that lay ahead.

"Our platform is all about bringing efficiencies to data transmission, be it trading, post-trade, mark-to-market, margining or billing," says Lamb. "Which is why we remain

ONE TO ONE: FRANCESCO SQUILLACIOTI

CONTINUING TO MAXIMIZING ASIAN GROWTH

In a Face to Face Q&A with Francesco Squillacioti, senior managing director in State Street's Securities Finance division and the Asia-Pacific regional business director. The Asian securities lending business has enjoyed several years of dynamic growth, accelerating more rapidly in the last couple of years. Squillacioti highlights the continuing and general air of optimism on both sides of the securities lending business in the region, involving activities within the actual lending markets as well as activities among the beneficial owners in the Asia-Pacific.

FTSE GLOBAL MARKETS: What are the main drivers of lending in the region?

FRANCESCO SQUILLACIOTI: Being such a diverse region, the drivers really vary from market to market and the complexion of the business inevitably changes from time-to-time. That said, in general, a lot of corporate activity – IPOs, mergers, capital raising, etc.— is fully at the heart of demand. I'd love to be able to predict the coming year, but it is particularly tough to call. Despite the past year having ups and downs, we've seen some strong performance from some of the markets, and overall, I feel that Asia did pretty well. If there is some stability this year and a continuation of corporate activities, along with our ability to continue to work effectively with beneficial owners, I would like to look forward to at the very least a reasonable year.

FTSE GLOBAL MARKETS: How is local regulatory reform impacting on the market?

FRANCESCO SQUILLACIOTI: For the most part, regulatory reform has been relatively positive in the Asian markets. Again, it's not a single, homogeneous market so it varies from location to location. Asia is in a situation where there are developed securities lending markets and developing securities lending markets. We see some markets that have been established for a few years making continual tweaks and improvements. I think of markets such as Taiwan in this category. They have continued to make refinements to their lending model. Other markets are reviewing changes to existing models to make them accessible to offshore participants. Then, there are markets that are just beginning to explore

implementing securities lending, such as China. So there is always plenty happening. Additionally, there are still many markets that are yet to implement lending.

FTSE GLOBAL MARKETS: Asia seems to be a two-tier market: established and embryonic. How does this dynamic impact on the provision of securities borrowing and lending services (SBL)?

FRANCESCO SQUILLACIOTI: It has a big impact. Established markets tend to be smoother, but the trade off may be lower spreads than less established markets. The less established markets, by virtue of their newness, could (but not always) vary from established protocols and require more individual attention, which can require extra effort from trading as well as operations, etc. At the same time, I would also say that this same dynamic applies to new beneficial owner types or markets where beneficial owners are just beginning to participate in securities lending. There can be substantial work required to engage these beneficial owners, to do the appropriate due diligence and then enrol them into the lending program. However, while there can be extra effort in this, it is also cause for encouragement since it represents the possibility of expanded opportunities for us across the region: new potential markets and potential clients, which will keep us busy.

FTSE GLOBAL MARKETS: Of the local beneficial owners involved in lending, are their key security requirements the same as in Europe or the US?

FRANCESCO SQUILLACIOTI: It truly is a case of all clients having different requirements. While there are

very focused on Japan, which clearly has a tremendous amount of data activity, given the size of its financing market. Right now we are close to bringing aboard some of the country's top trust banks, which we believe will greatly boost our standing in the regional marketplace."

Among EquiLend's most recent innovations is a trade-optimisation service suite, which allows clients to pool long and short assets and includes limits based on existing bilateral relationships, with the ultimate goal of providing complete optimisation of securities transac-

tions on behalf of the pool's contributors. Already a stateside success, EquiLend has set its sites on bringing the platform to other regions, including Asia. A recent run of trade-optimisation in Hong Kong proved enormously successful, totalling some \$45m in trade securities. "Obviously we're excited to see that kind of activity take place," says Lamb. "The market appears very willing to embrace new strategies, and we think this type of programme can create some interesting opportunities within the region." ■



many commonalities, I would say there are probably variations between clients in the region and in other parts of the world—even considering similar client types globally. The client base ranges from insurance companies, investment funds, and asset managers, to banks, pension funds and official institution type clients. They each have different ways of approaching securities lending, different expectations and requirements. I would say, though, is that most clients are quite focused on risk management, transparency and returns. On this point, I feel that we are well positioned, as we have always offered a program that placed a very high degree of emphasis on risk management and transparency. I think clients have appreciated this focus quite a lot, especially over the past few years. We focused on working closely with clients to provide a compelling lending program tailored to their requirements, and allowing them to access information about the program.

FTSE GLOBAL MARKETS: Where do you see new opportunities in securities lending in Asia?

FRANCESCO SQUILLACIOTI: The market is full of

opportunities, and I see them around the region. Some opportunities come from the size of the region; others come from the fact – as we discussed earlier – that there are nascent markets and some not even quite there. In terms of speaking with beneficial owners of assets, we continue to see across the region interest in securities lending and active engagement about securities lending. We are also seeing various developments in markets across the region that will, we hope, open up even more lending markets for us. Just the other day, for example, there were some positive changes announced in Malaysia. Our job then is to make sure that we are ready to take advantage of the changes, and that we are covering the markets, clients and potential clients well. I think we've done pretty well with that so far.

FTSE GLOBAL MARKETS: How does the development of the securities finance market in China dovetail into this vision?

FRANCESCO SQUILLACIOTI: It's most definitely a market of interest for us, as I'm sure it is for many others. While there is no offshore market for securities lending, the establishment of an onshore market for domestic participants is directionally quite encouraging. It's difficult to predict when there will be an offshore market, and I would think that the regulators would want to get comfortable with the construct and then expand it. The indications are that it will be a market worth waiting for, and so, it's an opportunity that we will certainly continue to gauge and watch.

FTSE GLOBAL MARKETS: Are markets such as Korea, Taiwan living up to expectations?

FRANCESCO SQUILLACIOTI: In a word, yes. These are examples of newer markets for securities lending. Korea is a bit older than Taiwan and both have performed quite well. We have been actively working on the trading side with these markets to find as much value as possible. We've also been engaging beneficial owner clients quite regularly about opportunities in these diverse markets. ■