The first industry-wide jointly sponsored conference in Asia developed by securities lending and borrowing professionals for securities lending and borrowing professionals.
On behalf of The Pan Asia Securities Lending Association (PASLA) and The Risk Management Association (RMA), we were honored to host you at the 15th Annual Conference on Asian Securities Lending. We hope you enjoyed the business program and it was able to provide practical solutions to challenges you currently face. The discussion topics in the conference business program were designed to be immediately put into action. Tuesday’s program allowed for new industry professionals to get up to speed on the basics of securities lending, while the following discussion from the PASLA board identified key market challenges faced by industry participants across regional jurisdictions. Wednesday’s program focused on developing markets in Asia-Pacific, emphasizing opportunities and challenges unique to the region. We were joined by Mr. Frederic Neumann, Co-Head of Asian Economic Research, HSBC who gave a strategic overview of the forces reshaping the global economy. Thursday we welcomed Mr. Mike Walsh, CEO, Tomorrow who discussed how firms can navigate the unique skills and potential challenges of your next generation of employees along with the secret of scaling up by designing work for small, empowered teams. Thursday’s discussion panels provided attendees with topics spanning the optimization of the firm’s balance sheet, the disruptive potential of fintech, as well as industry leaders presenting their view on the future state of securities finance and what your institution can expect moving forward.

PASLA is an association of over 60 firms that are active in the business of securities borrowing and lending securities in Asian markets. Our aims include liaising with regional markets to promote and develop appropriate regulatory frameworks for the industry, to represent the common interests of institutions engaged in SBL, and to assist in efficient and competitive market developments.

RMA is a member-driven not-for-profit professional association with approximately 2,500 institutional members. Its purpose is to advance the use of sound risk management principles in the financial services industry. RMA promotes an enterprise-wide approach to risk management that focuses on credit, market, and operational risks.

Attendees were encouraged to actively participate in the discussions to promote dialogue, share ideas, and debate the challenges facing our industry. We hope you enjoy the highlights of the 2018 conference. We look forward to seeing you at the 2019 conference in Sydney!
Regional Market Initiatives: What Have You Been Missing?

The PASLA board’s working groups have identified several key market challenges facing industry participants across regional jurisdictions in the Asia-Pacific markets.

**Hong Kong**
The Securities and Futures Commission (SFC) has identified some factors that are affecting securities lending in Hong Kong. Among these are parallel trading agreements and transactions, the short-sell eligible list of securities, clarity on short-sell procedures and the sale treatment of certain assets, and the issue of how to handle suspended securities. The Hong Kong Stock Exchange has identified similar issues, in addition to feedback on proposed changes to its website as well as comments on securities-based lending training and a market forum.

**Japan**
Japan’s securities lending market is focusing on growth through infrastructure building. This working group has identified several factors that could lead to market expansion. In 2017 the group looked at F1 and F2 and the settlement cycle to T+2. For domestic institutional lenders, this involved considerations surrounding technical development, later cut-offs on returns, and a broader collateral schedule. For domestic retail lenders, the focus was on technical development and operational flexibility, for example. The group also addressed corporate actions, focusing on uniformity of booking and best practice. Going forward, the group hopes to address central-counterparty transactions (e.g., benefits for borrowers and lenders and cost effectiveness) as well as automation.

**ASEAN**
Markets continue to evolve in this region. In the Philippines, a consultation paper on short-selling regulations was published in November 2017. Also, proposed rules using the existing securities borrowing and lending infrastructure were submitted to the Securities and Exchange Commission for discussion.

In Malaysia, the world’s first syariah-compliant alternative to the conventional securities borrowing and lending negotiated transaction framework, the Islamic Securities Selling and Buying Negotiated Transaction (ISSBNT), was announced in December 2017 and is waiting for contractual documentation. Various other reforms to the overall short-selling market have been introduced as well.

PASLA and the KPEI, the Indonesian Clearing and Guarantee Corporation, held discussions in early 2017 on the development of a bilateral securities borrowing and lending model. PASLA is also monitoring other developments concerning this model and has offered KPEI any assistance.

For all ASEAN countries, several settlement cycle changes are set to take place, with tentative dates of November 2018 in Indonesia; 2018 in Malaysia; late 2018 in Singapore; and March 2018 for Thailand, moving from a T+3 to T+2 settlement cycle.

**Sub Market Groups**
There have also been several developments in the Sub Market Groups, including:

**India:** Effective January 1, 2018, the Securities and Exchange Board of India revised its securities lending and borrowing framework. The revisions covered tenure, position limits (increased in line with market-wide limits for institutional investors), corporate actions (contracts allowed for nonvoting positions avoiding foreclosure), and rollovers (multiple rollovers to a maximum of 12 months from the date of the original contract). Also, revised transaction charges were announced by the National Stock Exchange of India effective March 1.

**Korea:** 2017 was a busy year for the Korea Sub Market Group. In May, the Korea Exchange (KRX) announced a short-sale portal, publicly reporting a list of the largest short holdings, short position balances per stock, the stock balance for market, short transaction data and other information. In June, the Financial Supervisory Service implemented changes to short reporting rules, including net short positions larger than 0.5% of the total issued shares must be reported. In September, KRX announced changes in the criteria for overheated stocks in the Kosdaq market. And in January 2018, the Ministry of Strategy and Finance retracted its proposal to lower the threshold for the capital gains tax on listed securities transactions from 25% to 5%, a decision that was made with input from various organizations during the consultation period.

**Taiwan:** 2017 was fairly quiet in terms of market developments. However, the rule changes that did take place were positive toward securities borrowing and lending, although they had a relatively minor impact. The focus onshore seems to be enhancing the short-sell quota system, continuing to provide the necessary protection while also bringing back liquidity to the short-selling mechanism. In 2018, the working group plans to focus on a number of topics, including presale borrow matching and/or recall delivery requirements; on-lending for financing and/or entity switching, corporate action reform, and a review of local lending income tax and dividend tax requirements.

**Conference Participant Commentary**
What did conference participants think about the securities lending and borrowing activity in these regional jurisdictions? In the postconference survey, when asked which markets require the most work to develop full lender participation, 36% indicated Taiwan; 33%, Malaysia; 27%, Thailand; and only 3%, South Korea. When asked which markets they would like to see open for participation by offshore investors, the majority, 68%, said China, followed by India, 18%, and Indonesia and the Philippines, 7% each.
Regional Legal and Regulatory Issues and Their Business Implications

What are the possible impacts on the securities lending business based on potential new regulations specific to the Asia-Pacific region?

Basel
The panel opened with a discussion of U.S. and global regulations, highlighting some of the important 2017 changes to Basel. For one, the 2017 Basel III reforms addressed some of the key weaknesses of the Basel II framework as identified by the Basel Committee during the financial crisis. The initial set of Basel III revisions focused on the numerator of the capital ratio while the most recent set of reforms focuses on the denominator, that is, risk-weighted assets. Negotiations of the 2017 reforms, said the panelists, was a difficult and painstaking process due, in large part, to the differing implementations of Basel II and III in member jurisdictions as well as to political pressure.

There were also some key thematic changes for Basel reforms, including a standardized approach for credit risk. For instance, the original Basel II/III reforms were perceived as overly simplistic, the panel noted, and insufficiently risk sensitive. The 2017 reforms introduced more detailed, granular risk weights for many exposure classes. There also was a push to reduce reliance on external credit ratings. Panel members noted an overreliance on external ratings that was perceived to be a major cause of the financial crisis. Certain jurisdictions, including the United States, also faced difficulties implementing the capital requirements based on external ratings. The 2017 reforms require banks to conduct sufficient due diligence when using external ratings and introduce approaches for jurisdictions that cannot or do not wish to rely on external ratings.

The panel also discussed the Basel Committee and internal ratings-based (IRB) approaches for credit risk. The committee concluded that banks, other financial institutions, and large corporates are considered to have low-default exposure, making reliable parameter estimation difficult. Therefore, the committee reasoned, it was unlikely that banks’ internal estimates of potential defaults or losses from such exposures would be any more reliable than estimates based on market data. The 2017 reforms no longer permit usage of the advanced IRB for exposures to general corporates belonging to a group with total consolidated annual revenues greater than €500 million and banks, securities firms, and other financial institutions.

Panelists noted the higher capital charges across the board for this exposure class for most banks. The impact on the United States is unclear, though, given that the U.S. implementation of Basel II/III does not permit foundation IRB.

Regional Legal/Regulatory Issues
Panel members also covered some main issues, including the Markets in Financial Instruments Directive (MiFID) 2. Key elements of MiFID 2 reform include the introduction of a new multilateral, discretionary trading venue, the Organised Trading Facility, for nonequity instruments; an expanded scope of the Systematic Internaliser category with increased transparency requirements; a new systems and controls requirements for organized trading venues; the introduction of trading controls for algorithmic trading activities; and an obligation to trade clearable derivatives on organized trading platforms. For commodities, there is a change in the scope of the regulatory perimeter for the commodities business as well as the introduction of a harmonized position limits regime for commodity derivatives to improve transparency, support orderly pricing, and help prevent market abuse.

Also, market transparency is to be increased, with the new transparency requirements for fixed income instruments and derivatives having the scope of requirements calibrated for liquidity. The reforms also include a requirement to submit posttrade data and transaction reports to authorized providers, increased conduct of business requirements to improve investor protection, strengthened supervisory powers and stronger administrative sanctions to ensure effectiveness and harmonization.
What are some of the elements that have been successful in expanding off-shore securities lending markets? Some of the traits of a success model include:

- Vitality of underlying securities;
- Flexibility of market structure;
- Transparency of securities borrowing and lending (SBL)-related information; and
- Neutrality of market regulation.

The panelists focused on Taiwan and its possible success as a securities lending model. Based on the above-mentioned traits, the numbers seem to say it is on the right track. SBL transactions (Taiwan Stock Exchange negotiated) were higher in 2017 than in the past several years. Also, 2017 milestones included extended trading hours, the release of the SBL daily short-selling limit, and relaxed qualifications for participating SBL systems. Last year saw some additional market reforms the integration of the SBL-related official interpretation, an extended roll-over limit from once to twice, and the removal of QFII restrictions in the TWSE SBL system. Potential 2018 reforms include the establishment of a prematching system and an info-exchange platform to increase the efficiency of daily trading process between brokers and custodian banks, a close-out netting clause for counterparties’ insolvency, and further relaxation of the percentage restriction on daily short sales.

The National Stock Exchange of India noted its SBL evolution starting in April 2008, when SBL was launched with tenure of seven days. That was followed in October with tenure of 30 days and timing extended to six-hour sessions. In January 2010, the monthly tenure contracts were extended up to 12 months, with early closure of positions allowed as well. In 2012, exchange-traded funds were added as eligible securities, followed in 2015 with nonderivative scripts added as eligible securities. Last year the market saw revisions in the position limits for FIIs, multiple rollovers up to 12 months allowed, and the removal of mandatory foreclosure. Daily average turnover has reached more than US$10 million in 2017, more than double from 2015.

**Conference Participant Commentary**

Despite the success of some SBL markets, some asset owners are still apprehensive. When asked why some are still opposed or slow to adopt securities lending, particularly in this region, 47% cited a lack of understanding or the operational capacity to participate. Twenty-two percent said they were philosophically opposed to lending (e.g., short selling), while 17% said the lending risks just aren’t justified by the returns and 14% had concerns the credit risk of counterparty/market volatility. Some of the key challenges to mainland securities lending expansion noted by participants were regulation (80%), inventory and willingness of market participants (9% each), and information (3%).
Risk and Reward in Securities Lending - Is It Really Worth It?

In a world of compressed yields and lackluster investment returns, securities lending has been an effective solution for many asset owners seeking alternative avenues of alpha generation at relatively low risk. Despite continued momentum in beneficial owner program participation, there remains a perception that inherent risks within a program do not warrant the associated revenue potential. Are these perceptions justified? How has securities lending evolved since the global financial crises in helping participants manage risks appropriately? Are beneficial owners using a different lens today to assess the value proposition of securities lending? And how have participants been successful in striking the right balance among risk, reward, and governance?

During the global financial crisis of 2008, securities lending was often mentioned in a negative context: it was seen as being responsible for the losses at AIG and for the dramatic drop in equity markets after Lehman Brothers closed its doors in September 2008. Several markets introduced short-selling bans in a vain attempt to halt the rout in their domestic equity markets, but markets continued to fall anyway. The financial world has stabilized since then and has reached a new “normal,” with interest rates beginning to rise, quantitative easing abated, equity markets at all-time highs, and the outlook for the global economy generally seen as more positive. As a result, Securities Lending has continued to operate and, according to some observers, recover to a level equal to (or greater) than before the crisis.

Despite the return of inventory and compelling drivers to use securities lending since the global financial crisis, it is apparent that some asset owners prefer to take a “wait-and-see” approach to lending, or are alternatively opposed to Lending. Of course, there are many reasons why this is the case, but panelists grouped them into five broad categories:

- Returns not worth the risk;
- Short selling driving down asset prices;
- Institutional/individual reputational and/or headline risk;
- Administrative burden of running a SL program; and
- Senior management and/or board approval is withheld.

Participants were not without their opinions, however. When asked to define what is needed to try to change the dynamic of asset owners reluctant to adopt securities lending, the participants noted, among other factors:

- Better risk management/controls for securities lending;
- Demystifying securities lending;
- Beneficial owner education of risk versus reward; and
- Internal support from senior management and the board of directors.

Conference Participant Commentary

Technology seemed to play a role in participants’ opinions about the rewards and risks surrounding the securities lending industry in general. When asked how technology can work to their advantage, 47% said technology creates scalability, 25% pointed to lower costs in the long run, 16% said it optimized pricing, and 13% said it optimized their allocation models. When asked if technology innovation in the securities lending industry concerns all SL participants, 60% said yes, 33% said no, and 7% were unsure. Overall, despite any risks, they remain optimistic, with 72% saying they will grow their usage of the secured financing market in the next 12 months, while only 24% said it will stay the same.
I would like to thank all of our attendees for joining us this year in Hong Kong. I believe this year’s conference was very successful in terms of the breadth of knowledge shared as well as the relationships strengthened across the industry. Thank you to all of our speakers and moderators for sharing their insights with the conference as well as to the sponsors for helping PASLA be able to hold this event each year. I hope you found this year’s program insightful and look forward to seeing you again next year in Sydney!

Stuart Jones
Chair of PASLA

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## DATES AND LOCATIONS OF FUTURE CONFERENCES

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<td>RMA CONFERENCE ON SECURITIES LENDING</td>
<td>35th Annual</td>
<td>October 8–11, 2018</td>
<td>The Ritz-Carlton Key Biscayne,</td>
<td><a href="http://www.paslaonline.com">www.paslaonline.com</a>&lt;br&gt;www.rmahq.org/securities-lending</td>
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<td>PASLA/RMA CONFERENCE ON ASIAN SECURITIES LENDING</td>
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Please note: These dates and locations are provided for your information only. Hotel group reservations will not be available at any hotel before RMA’s release date.

We look forward to you joining us this upcoming year in Sydney!