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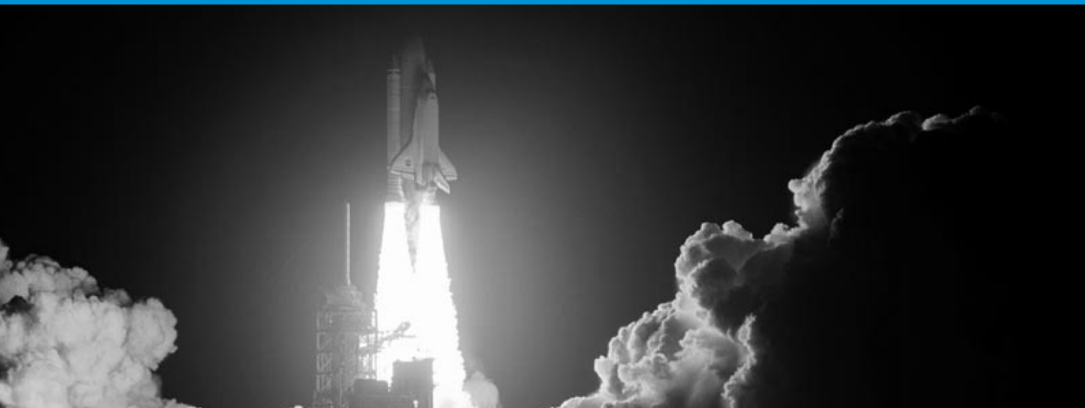

First European mini-prime launched

LONDON 18 10.2010

Global Prime Partners (GPP) has launched the first introducing prime brokerage service in Europe, providing clearing, custody, securities lending and financing services for emerging hedge funds.

The services will be provided through correspondent relationships with Jefferies, KAS Bank and Nomura.

GPP's prime brokerage business is led by Kevin LoPrimo. He joined from hedge fund G2 Group in November 2009 and was previously an executive in the prime brokerage divisions of Merrill Lynch and Goldman Sachs where he spent nearly 20 years.

London-based GPP has been providing clearing services for individual traders and start-up hedge funds since it launched two years ago. LoPrimo has spearheaded the introduction of stock lending and financing services and enhanced GPP's trade execution capabilities since he joined.

GPP will focus on start-up hedge funds and emerging managers with under $100 million in assets.

"This segment of the market is underserved by the bulge bracket banks but is a sizeable opportunity for GPP. There is less capital flowing into hedge funds than a few years ago and a lot of managers are launching with $5-$25 million in assets. We can help them get up and running at a much lower cost and provide a higher level of service than the big banks," said LoPrimo.

GPP plans to have a capital introduction team in place in the near future to help clients raise assets, he added.

GPP has also entered into a partnership with Olive-Tree Securities, the equities brokerage established in April 2009 by former Morgan Stanley executive Daryn Kutner.

"We have a number of hedge fund clients that are either looking for a second prime broker or an alternative

read**more p3**

NEWS**IN**BRIEF

Securities lending market place expands data offering

Quadriserv has announced that it has expanded its AQS Market Data products and services to include industry wide access. This latest offering will facilitate broad distribution of real-time securities lending market data for equity, ETF, index, and ADR products traded on AQS.

read**more p3**

Wachovia Global Securities Lending rebrands as ClearLend Securities

Wachovia Global Securities Lending has rebranded as ClearLend Securities. The newly-named business is a combination of the operations of Wells Fargo Securities Lending and Wachovia Global Securities Lending.

Wachovia Securities, the retail brokerage operation of the bank, is now known as Wells Fargo Advisors.

A spokesperson for the bank said: "The new brand conveys our commitment to serving the needs and meeting the objectives of our clients. The decision by current management to rebrand the division was made in order to better position ourselves in the marketplace. Liquidity, transparency, performance and trust will be the hallmarks of our programme.

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INSIDE SECURITIES**LENDING**TIMES

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First European mini-prime launched

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provider. GPP offers a service that specifically addresses the needs of these clients," said Emmanuel Bousquet, head of sector strategy at OliveTree.

The partnership means GPP's clients will also have access to OliveTree's research and brokerage services.

LoPrimo said GPP planned to enter into "a series of strategic partnerships with specialists", as it looks to expand its business.

Introducing primes like GPP have become a fixture of the US hedge fund business over the past five years. Companies like Merlin Securities and BTIG have built a strong following among small and mid-size hedge funds, which have historically been underserved by the bulge bracket banks.

Cantor Fitzgerald and Lazard have also recently established prime brokerage units targeting smaller hedge funds. European regulations have complicated efforts to replicate the "mini-prime" model in Europe. Merlin Securities planned to open a London office earlier this year but has since abandoned those plans, opting instead to expand in Canada and Latin America. "The regulations in Europe do make it more difficult to get this business up and running, but through our clearing banks we have been able to find a model that works," said LoPrimo.

Securities lending marketplace expands data offering

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"Expanded access to AQS Market Data Services' suite of products brings a new dimension of actionable, transparent market information to the securities lending industry," said Thomas Little, president, AQS Market Data Services. "This market innovation underscores our conviction that reliable, real-time, and publicly available data is an essential component in the growth of liquid, regulated electronic markets. Ensuring the integrity and accessibility of this new data is of paramount importance as we move together with our distribution partners and members to bring the product to market.

"We are pleased that this data been received positively both by the traditional securities lending market as well as the equity and equity derivatives markets. This latter development further validates Quadriserv's long held belief that access to transparent and reliable data will, in turn, yield a more efficient securities lending marketplace with enhanced liquidity and pricing that grows the market."

Consistent with existing AQS market connectivity options, real-time AQS Market Data will be available through a wide variety of existing and new subscription channels, including analytics platforms, APIs and data feeds.

Risk in securities lending research paper launched

Data Explorers has published its research paper on risks and returns in lending programmes. The paper, *Securities Lending - is the risk worth the return?* recognises that securities lending remains a steady source of additional revenue for many asset owners and seeks to shed more light on how risk and return are balanced in different programmes.

The paper looks at the range of returns and risks across a sample of these funds, summarised by provider.

The paper shows that in one example week, some programme returns may be little more than a few annualised basis points; others may be earning the annual equivalent of one per cent or more - enough to rival some active portfolio managers. Comparison of risk and return shows that some funds are earning high returns with limited risk while others are carrying a high risk level without appropriate compensation.

The study also looks at returns over longer periods, and this shows a very different picture. Programmes running the most risk are those which have accumulated large cash buffers from previous stock lending. Perhaps this buffer encourages risk taking; or perhaps successful programme managers have a stronger appetite for risk and achieve above average returns.

These results show that securities lending returns can be significant, especially over longer cumulative periods, and especially for those willing to absorb collateral risk.

David Carruthers, segment director at Data Explorers, said: "Asset owners continue to find that securities lending can be an important source of diversification in their return mix. The data shows that many programmes have achieved good, even outstanding risk adjusted returns. And help is at hand for those who have not."

Wachovia Global Securities Lending rebrands as ClearLend Securities

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Supported by the financial strength and resources of Wells Fargo, ClearLend will continue to provide customised solutions and superior service to our clients.

"With the rebranding, there will be no changes to clients' service or reporting (all report deliverables and services will remain the same) and there are no changes to the management team and staff. Our long-standing management team remains in place and clients' day to day relationship managers and staff contacts will be the same."

Following a turbulent time for banks grappling with the credit crisis and the Lehman Brothers default, October 2008 saw the announcement of the Wachovia-Wells agreement.

An abrupt change of course saw Wachovia Corp. agree to be acquired by Wells Fargo & Co. One key difference is that the Wachovia deal was done without government assistance, while the Citigroup deal would have gone through with the help of the Federal Deposit Insurance Corp.

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Collateral management 'next big challenge'

A SunGard-sponsored study on collateral management has revealed that collateral optimisation and efficient collateral management are the next big challenges in capital markets, with more than 60 per cent of respondents stating that a cross-silo view is important for collateral management. Firms will need to improve their cross-product, firm-wide risk management of collateral of all types, and optimise returns from collateral trading in order to help them remain competitive.

The study, issued by Finadium, was conducted using an online survey in June and July of 2010 and was completed by 122 professionals directly involved with collateral management on a day-to-day basis. Respondents were primarily senior management and operations executives from banks and asset management firms in Europe, North America and Australia, working in the areas of OTC derivatives, securities lending or repos.

The need to meet Basel III recommendations and other new regulatory mandates is driving the use of enterprise-wide collateral management technology. Survey participants expect that collateral optimisation, including managing cross-product netting and the use of central credit counterparties, will be their next focus areas for advancement.

According to Josh Galper, managing principal of Finadium, "Collateral management will be foremost in the minds of banks and their counterparties through 2011 and 2012. An expanded use of both cash and non-cash collateral across bilateral and centrally cleared markets will require financial market participants to optimise their operations and technology in order to help them remain competitive. As regulators worldwide focus on expanding capital requirements, banks and their clients will face new challenges in maintaining liquidity for their trading operations. Making sure that the right collateral has gone to the right counterparty, including central credit counterparties, will help keep liquidity intact."

According to the research, the amount of collateral outstanding for financial transactions rose 15-fold over the last decade, driven by surges in derivative transactions. Products that require collateral management are often handled in silos within organisations by product and/or by geographical divisions among derivatives (OTC and listed), equities, fixed income, and foreign exchange and money markets. SunGard's collateral management study reveals that:

39 per cent of respondents see risk mitigation as the sole purpose of their collateral management efforts, while 54 per cent believe collateral management should be used for both risk mitigation and revenue generation. For the 25 per cent of respondents moving toward firm-wide collateral management, securities lending and repos are by far the most popular targets for consolidation. 77 per cent of respondents plan to consolidate securities lending collateral management, and 68 per cent plan to include repos. 64 per cent of respondents said they were somewhat to very prepared for new Bank for International Settlements (BIS) changes.

New European equities CCP completes first trade

Omgeo and EuroCCP have announced that their new pan-European equities matching and central counterparty clearing (CCP) service for hedge fund transactions has executed a live trade with prime broker and executing broker, Credit Suisse, and hedge fund manager, Citadel. Credit Suisse and Citadel intend to continue to partner with Omgeo and EuroCCP to ensure that their interfaces become scalable and ready to be extended to a broader range of counterparties in the future.

The service allows executing brokers and prime brokers to clear hedge fund transactions, will streamline the processing flow and mitigate the counterparty risks associated with these types of institutional cash equities transactions.

The new processing solution combines Omgeo Central Trade Manager, which provides a fully automated matching service, and EuroCCP's CCP service which clears and settles pan-European cash equity trades. The joint service initially covers 15 European markets and expects to be expanded to additional markets over time. Following the successful piloting of the solution and first live trade, the service will be gradually rolled out to hedge funds and their executing and prime brokers. It is also the intention to make the service available to institutional fund managers and their brokers in the future.

Hedge funds will access the service through Omgeo CTM and through their executing and prime brokers who are EuroCCP participants. These brokers will authorise locked-in trades and release them to EuroCCP, where the trades are novated, netted and routed to the relevant European central securities depository (CSD) for settlement on a netted basis.

Neil Martin, MD, cash securities clearing & settlement, Credit Suisse, said: "We are pleased to successfully test and execute a first live trade on this trade matching solution. Adding central counterparty netting to the trade processing flow between us and our clients enables us to reduce counterparty risk and improve operational efficiency."

Todd Schroeder, deputy head of global operations at Omnium, an affiliate of Citadel, said: "Having access to the benefits of a CCP solution and the trade guarantee it provides is of great value to hedge funds and investment managers. The ability to provide efficient straight-through processing coupled with a greater degree of risk mitigation for our clients is of utmost importance to Citadel and having this new service available to us in the marketplace is a major step in effectively meeting those needs."

Adding to this, Leigh Walters, global head of sales, Omgeo, said: "Omgeo and EuroCCP have been working closely with an industry user group to develop the new processing solution. Now that the necessary links to Omgeo CTM and EuroCCP have been built and this new revolutionary trade matching and CCP solution has executed its first live trade, we anticipate further hedge funds and brokers to come on board in the ensuing months."

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Information Mosaic launches Asset Surveillance

Information Mosaic has launched its new Asset Surveillance solution. Designed to help financial institutions provide top down transparency across their entire custody and depository network in a clear, risk-oriented way, Asset Surveillance provides a consolidated view of network and depository counterparty risk through a single user interface.

Information Mosaic has worked closely with a number of its clients to create a solution that provides risk diagnostics and assessment using unique risk visualisation and presentation tools. Risk is automatically assessed and flagged against custom-set parameters providing an up-to-the-minute snapshot of exposure, while the risk simulation feature allows for 'what if' analysis, ensuring a clear understanding of the risk associated with every decision. This level of transparency provides custodians and their institutional asset manager, fund and HNW clients with a complete view of risk from portfolio to individual trade, helping restore trust in the market.

"In a market where the ongoing debate is who carries and who should carry responsibility for custody and sub-custody risk, there is a clear need for systems that provide meaningful risk assessment of each trade pre-settlement and under custody. Custodians now have the chance to create new services for monitoring network counterparty risk, helping them cement their roles as trusted guardians in the process," commented Rik Turner, senior analyst, Ovum. "It's this top down transparency that allows investment managers to make the necessary decisions to mitigate risk."

The new solution is easily integrated with existing systems and is completely customisable to any organisation's risk metrics. The flexible risk parameterisation provides a clear snapshot of risk via an intuitive user interface, which can be accessed from any browser-based device, creating a fluid user experience. Users can receive proactive alerts via SMS and email, enabling quick and easy decision-making to mitigate risks as they arise, regardless of where they are.

"When Lehman collapsed, it took many financial institutions not days, not weeks but months to unravel their exposure to the failed bank. Our Asset Surveillance solution gives the real-time view of network counterparty risk that ensures this sort of confusion could never happen again. Custodians have a unique opportunity to be the white knights of risk in this scenario, providing a definitive picture of where they and their investors stand on assets under custody," said John Byrne, CEO at Information Mosaic. "Our clients are looking for new and innovative ways to help provide increased portfolio visibility to network managers, risk officers and clients such as asset managers. It is this deeper level of transparency that will enable the markets to trade confidently once again."

Other key features of Information Mosaic's Asset Surveillance solution include extensive search and sort functionality on portfolio views, enabling a client, portfolio or individual trade and position level perspective. Data can also be rapidly assimilated from across the enterprise, improving transparency and delivering a quick time to market for new services.

Lenders to receive divi at SEBI

The Securities and Exchange Board of India has said the lenders are now eligible to receive the dividend income on lent securities.

The regulator said the move was made to improve the development of the securities lending market.

SEBI announced partial modification to its earlier circular of 31 October 2008, to read, "The dividend amount would be worked out and recovered from the borrower on the book closure / record date and passed on to the lender."

The other provisions, as specified in its previous circular of 20 December 2007, on "short selling and securities lending and borrowing" framework" will continue to be applicable, SEBI said in the circular.

Securities lending leaps ahead at OCC

There were 59,460 new loan transactions in September. Year-to-date securities lending activity is up 64 per cent from 2009 with 459,664 new loan transactions in 2010. OCC's stock loan programme had an average daily notional value of $14,249,591,128.

Total OCC cleared volume in September reached 303,851,940 contracts, representing a four per cent decrease over the September 2009 volume of 316,624,143 contracts. OCC's year-to-date average daily volume is up six per cent compared to 2009 with 15,332,099 contracts and year-to-date total volume is up six per cent with 2,882,434,696 contracts.

Options: Exchange-listed options trading volume reached 302,075,193 contracts in September, a 4 per cent decrease from September 2009. Index options trading rose seven per cent from the previous September. Year-to-date average daily contract volume for exchange-listed options is up five per cent compared to the same period last year with 15,233,031 contracts.

Futures: OCC cleared 1,776,747 futures contracts in September, a two per cent decrease from September 2009. Equity futures volume was 359,068 contracts, a 14 per cent decrease over the same month last year. Index and other futures volume rose two per cent over the previous September with 1,417,251 contracts. Year-to-date average daily contract volume for futures cleared by OCC is up 177 per cent compared to 2009.

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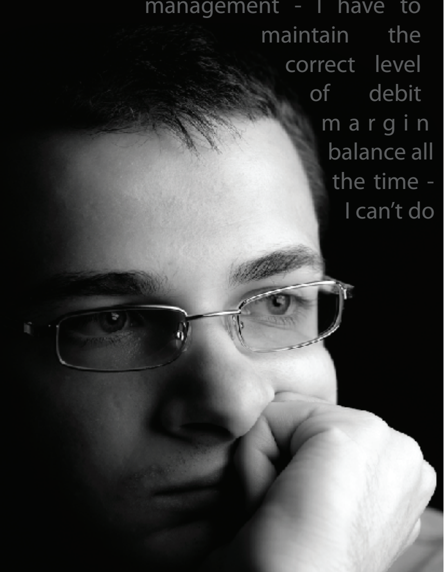

27th Securities Lending Conference

Securities Lending Times enjoyed the vibrant discussion at the RMA's annual jamboree

Justin Lawson Reports

The 27th Annual Securities Lending Conference organised by the RMA took place last week at the Boca Raton Resort. Coming over from London it was great to leave the cold, dark, autumnal weather for the Miami sunshine. With such great weather, venue and golf course the most difficult question to answer was 'do I attend the sessions?' - of course I do, must and did! With so many industry changes and great speakers it was important for the delegates, myself included, to hear other people's views and keep up to speed.

The first session was a look at some of the emerging Latin American markets sponsored by Citi. With 50 people registered to attend the session it was great to see over 100 turn out and participate. Markets covered included Brazil, Mexico, Chile and Columbia. Whereas previous conferences have seen discussions touch on Brazil and Mexico the discussions featuring the new markets gave food for thought. One of the most interesting forward movements is the Columbian market and also the current restrictions to building an effective securities lending infrastructure within the country.

"Pension funds are not allowed by law to execute securities lending at present," reported Christian Jarrin, foreign investor relations manager, at Correval

This and many other areas are undergoing a period of review and a number of changes will come into effect before the end of the year.

Over the course of the conference one of the most impressive aspects was the high attendance to the various sessions. In an industry where there are far too many conferences, some good, but some extremely poor, the association events are still clearly the first on your list of 'must attend'.

The keynote speaker, award-winning journalist and best-selling author, Sebastian Junger was emotional in his account of time spent embedded with the battle company of the 173rd Airborne Brigade Combat Team, in the remote and heavily contested Korengal valley of eastern Afghanistan. Junger detailed his fascination with 'courage' and in what was an interesting twist he became the second keynote speaker in three years to incorporate chimpanzees into his talk and we learnt about their fighting instincts - a far cry from Stephen Dubner, author of Freakonomics, recounting various economic experiments carried out with the aforementioned subjects.

'Life requires courage' Coming full circle the presentation was brought round to how in our world we all need courage in day to day activities from starting a business to relocating into unknown countries.

Concluding Junger carried on to describe his view on how people act in pure self interest but to get around this and get the best out of people he raised three points:

- Leadership has to share the risk
- Equal aspect to respect
- Lateral discipline

These can be taken into any walks of life and business, and in a tough economic climate, the securities lending industry needs those skills more than ever. **SLT**

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Russia

Russia's enormous potential is being reached more slowly than was first anticipated, and there's still work to be done if its securities lending industry is to become a major player on the world stage

BEN WILKIE REPORTS

Russia remains a country of contrasts and unpredictability. It has one of the world's greatest reserves of natural resources, and many of the world's billionaires are Russian. Its economy has performed reasonably well over the past decade, and even during the financial crisis of the past couple of years it has done ok. It has an educated and international-looking population, and the reforms over the past few years have encouraged more and more inward investment.

Yet many international firms are reluctant to get involved. As communism fell, Russia was by far and away the largest country - both in terms of size and economy - to enter the global markets and it became a kind of experiment for the free market economic thinking of the Chicago School. Hundreds of firms were privatised, and financial markets were opened up.

But maybe this happened too quickly. International investors remain wary of the sometimes shoddy regulatory structure of many financial instruments, and afraid that regular political interference will affect their holdings. While some of the country's elite have become very wealthy indeed, many of Russia's population remain on or below the poverty line. And although the 'Wild West' atmosphere that allowed virtually anything to go in the early 90s has largely disappeared, many respectable finance houses don't want to run the risk of being tarnished by dealings with some firms. There are also concerns that there appear to be one rule for domestic firms, and another for international players.

Russia is a huge market and an enormous opportunity. It has certainly officially opened its doors to the wider world. But there remain fears that those doors may be revolving.

Attempts to organise the securities lending market on the Russian market have been ongoing ever since the company emerged from the ravages of the Soviet Union, but so far this market segment has not yet developed enough to meet the potential demand.

This is down to a number of reasons, but chief amongst them is that the regulatory infrastructure is simply not yet there. The securities lending mechanism is not legitimised, which scares away many of the international players, as well as domestic beneficial owners who need the safety of a regulatory mechanism to ensure their portfolios are protected.

"You have to remember that Russia has come a long way in the last 20 years," says one manager of a private office in Moscow. "The likes of the US and the UK have had a century or more to get their infrastructure in place, while we have had less than 20 years. When the market reforms were introduced [at the time Russia became a capitalist economy], mistakes were made and we have had to take our time to get them resolved. But it's a slow process, with a lot of vested interests and securities lending is not at the top of the agenda."

The financial crisis of August 1998 looms large in the memories of many investors. Because

there were no mechanisms in place to protect lenders, significant losses ensued, and many participants are still avoiding the market as a result.

International funds focusing on Russia are growing, but there hasn't been the demand here that has been seen elsewhere

In a report on the Russian market by the Center for the Study of Financial Market Evolution, executive director Ed Blount said the problems of 1998 have still not been resolved. "Domestic securities traders are unable to create efficient short positions, either for the kind of dynamic hedging strategies that are needed to service the growth of domestic institutions or for the kind of programme-based proprietary strategies which support liquidity in domestic markets," he argued.

Currently Russian securities legislation doesn't specify a legal relationship for securities lending; they are generally organised as a sort of combination of purchase-sale relations. As a rule, these deals are stipulated by repo contracts, ie, a purchase-sale contract, including a provision that obligates the 'lender' to buy back the securities on appropriate date and at a fixed price.

Problems arise when attempting to apply a legal model of the loan or a commercial credit to the securities. Usually the securities borrowed or those purchased with an obligation of the owner to buy them back, are not sensitive to short-term fluctuations of the market demand or dependant on strategic investors will be sold immediately after their delivery.

On the date of execution of obligations under loan or on a buyback date, in order to meet the obligation an appropriate amount of securities to be returned is purchased and returned to the beneficiary-owner.

Here, though, there are constraining factors that make such big operations very risky for market participants: they have to provide a collateral in the form of liquid assets (other securities or cash) or buy out an appropriate quantity of securities for loan settlement. Secondly is the issue of the two competing Russian depositaries.

"Two depositaries just doesn't work," says a representative of one of the depositaries. "It makes it far more complicated for regulators, it makes it far more complicated for domestic investors, and it makes it virtually impossible to build up a securities lending infrastructure that will attract international players. One of them needs to go. Of course, I hope it is the other one [that pulls out], but to be honest it doesn't really matter which one takes on the responsibility and which one leaves the market, so long as the situation is resolved."

Popular stocks

Global investors are very active in borrowing shares of major Russian securities firms, particularly those of Yukos and VimpelCom, in order to create short positions, says Blount. Many outsiders might automatically assume that short sales would tend to depress the prices of these two Russian companies and translate negatively into the Russian domestic markets. In fact, by using a proprietary database of global securities loan activity, precisely the opposite can be shown to have happened.

Just as was evident for American securities in American markets, many global short-sellers created market liquidity for Russian securities and contributed to price cushioning when market prices turned downward. In all likelihood, the arbitrage effect of this activity also translated its beneficial impact to the Russian domestic markets. Equally likely, a similar cushioning in the domestic markets could have taken place directly, if the Russian markets enabled the borrowing and shorting of domestic Russian securities, not just for these two issues, but also for many other liquid Russian securities issues.

Beneficial owners

The use of investment funds by private investors in the country is growing - and in fact that growth has been impressive considering such vehicles were literally unheard of 20 years ago - but as with much of the Russian economy, many of the moves are being driven by the very wealthy.

Private offices make up much of the investable wealth in the country, yet these offices tend to be more international in outlook than the domestic funds. While they do continue to invest in the country, this is often down to the political atmosphere.

"We involve ourselves through our service providers in securities lending in many territories in Europe and Asia, although not so much in North America," says the private office manager. "While we do invest significantly in Russia, we do so more because we don't want to attract attention for sending our money overseas and as such, because there are issues around securities lending, we have a valid reason for not getting involved in it - and while we would like to have the opportunity to carry out transactions, it is not now or ever going to be the primary focus of our business."

International funds focusing on Russia are growing, but there hasn't been the demand here that has been seen in other emerging economies such as Brazil. One fund prospectus details the "potential" for expropriation, dilution, devaluation, default or excessive taxation by the Russian government, plus other risks, which include but are not limited to convertible and debt securities risks; market trends risks; price volatility risks; other investment companies risks; settlement and custody risks; inability to sell securities risks; and securities lending risks.

As a result, international activity remains small. Currently, securities lending is associated with the following types of risks:

non-return risk, and risk related to non-exercising rights, such as voting rights, right for dividends or other incomes. In addition, there are also issues related to taxation of income/loss derived from securities lending operations.

"We know that Russia has huge potential and we want to be part of that."

"In the current climate, the emphasis is on protecting the value of the fund," says one London-based fund manager with significant exposure to Russia and many Eastern European markets.

"We know that Russia has huge potential and we want to be a part of that. So a couple of years ago we may have taken the risk and got involved in securities lending to bring in extra income, but today we just can't - our investors want us to make money for them, but more importantly they don't want us to lose the money they have invested and we simply cannot justify the exposure that securities lending in Russia gives us." **SLT**

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There's an App for that!

SunGard's John Grimaldi examines how mobile devices could be the future of securities lending

MARKET RESEARCH

It seems every day; a new application is introduced to run on our mobile computing devices or cell phones. During the summer of 2005, I attended a company event in which the keynote speaker prophesised that the personal computer is dead. Handheld devices, which we call cell phones (or at that time, PDAs), would eventfully replace the PC. It was a pretty bold statement then, but today, that prediction is beginning to ring true.

In today's tech savvy society, we can use our handheld devices to buy merchandise, take pictures, download music, record and watch videos, watch live broadcasts, make dinner reservations, trade stocks and perform online banking functions. The functions and capabilities are endless and are growing exponentially each and every day.

Is it foreseeable that in the not-so-distant future securities finance and related transactions could be conducted from a handheld device? Technology could eventually lead us to the possibility, but not before the securities finance industry evolves in terms of business transformation and trading automation. In addition, we all will have to convince our respective corporate information security officers that such mobile applications are secure, encrypted, and able to protect confidential information. If trading from our handheld devices is not the next leap in trading automation, then what does lie ahead in the technology lifecycle?

Before we can discuss what comes next, we need to review the past and current state of automated trading.

The way we were – a look back

Electronic trading, screen-based trading and trading automation have been common terms for more than two decades. Where did it all begin? In the late 1980s and early 1990s, the early version of electronic trading arrived on the scene. Early automation was predicated on a borrower creating a flat file of borrow requests and coordinating the transmission of the file to the lender, where the lender needed to interpret the data and then send back another flat file with answers. Typically, the turnaround time of data ranged from 30 to 60 minutes. For its time, this was effective and far better than picking up the phone and requesting to borrow hundreds

of general collateral securities. As time went along, the file transfer process was refined and turnaround times improved, but it was still a serial process that required a response from the first lender before requests could be sent to the next lender.

The next milestone was the creation of lender specific web sites, where borrowers would sign into various lender sites to view availability and request loans. Like file exchanges, it was a serial process. Borrowers were forced to navigate between file submissions and web sites throughout the day. For volume in general, collateral orders were still better than making many phone calls, but the process still remained somewhat cumbersome.

In the late 1990s, SunGard introduced Loanet Centralised Order Routing (LCOR) in the US. It was the first real-time, message-based routing system that allowed for real-time borrow requests to be communicated from the borrowers to lenders. The borrowers did not have to wait for lenders to respond to all of their requests before sending to the next lender. As messages were responded to, they were routed to the next lender in the case of unexecuted orders. This eliminated file swapping, failed transmissions and long turnaround times, as well as the need for lender specific web sites. Orders were systemically routed directly to the lender's system of decision. LCOR is a scalable, volume-driven alternative to previous approaches and today handles more than 100,000 borrow requests per day.

The current state of technology

Over the years, technology kept moving forward. Desktop computers and applications have become more powerful, resulting in the proliferation of spreadsheets and emails to transmit and receive request/orders to satisfy the insatiable demand for quicker turnaround of information.

As with many other aspects of our current society, technology creates the desire/need for instant gratification, and the securities finance business is no different. Beyond email, many traders continue to utilise instant messaging and Bloomberg terminals to provide an alternate communications vehicle to conduct business.

In addition to speed and ease of use, the business now requires market data to provide enhanced transparency around liquidity, utilisation and market depth, as well as augment internal data in order to analyse trends, risk and earning opportunities and make trading decisions. The trader's desktop has changed dramatically and is a far cry from the days when traders simply entered a loan or borrow transaction.

To support the tremendous growth of the last decade (excluding the financial crisis of the last two years), various trading venues were created. The earlier part of the decade saw the launch of EquiLend, SecFinex and other entities, all looking to provide trading automation in an effort to streamline the process. Additionally, the creation and launch of the OneChicago single stock futures exchange provided a synthetic securities finance product and trading venue. Industry participants adopted slowly as they continued to utilise various electronic mechanisms to conduct the majority of their business in the bilateral market.

Securities finance trading markets and technologies are advancing to the point where the securities finance trader, the equity trader and the fixed income trader will have similar tools

In the second half of the decade, Quadriserv launched the first electronic direct access securities lending market, partnering with The Options Clearing Corp. (OCC) to provide a central counterparty (CCP) clearing environment to facilitate settlement and mitigate risk. This represents the beginnings of the securities finance exchange model in the US.

What's next?

Electronic securities finance trading platforms will continue to expand as entrepreneurs and vendors look to establish their respective niches and exploit inefficiencies in the industry. The success of multiple trading venues, securities lending exchanges, and the continued automation of the bilateral market will continue to fuel the demand and increase the need for real-time market data. Transparency will finally arrive and take its rightful place in the securities finance business processing chain, along with trading, operations, settlement and risk.

Traders will not be satisfied to do all of their business in a single venue. Opportunities exist or are created when trading is available in multiple venues. The securities finance trader wants what the equity trader has: a single screen from which to see multiple quotes from multiple exchanges and/or trading venues, and the ability to execute through a common access point handled by an order management system (OMS).

The next iteration of securities finance trade technology will need to provide the end user with a single view of multiple quotes, alongside both external market and internal data to help support trading decisions and execute within seconds. The ultimate goal is to provide a trading platform that presents a global view for receiving market bids and offers.

Going forward, the real challenge is in managing orders across multiple trading venues while remaining in compliance with regulatory rules. For example a US broker-dealer subject to SEC 15c3-3 customer protection rules and attempting to lend securities by trading on multiple venues needs to be able to manage its orders to avoid dual usage, thereby ensuring a regulatory violation does not occur. Sophisticated order routing, order management technology and decision-making applications will be required to successfully operate and take advantage of market variances across multiple markets. Fully enabled, screen-based trading technology with market data for analytics, balanced with collateral optimisation and risk management, is the next generation.

Conclusion

Technology and business transformation are on a path of convergence. Securities finance trading markets and technologies are advancing to the point where the securities finance trader, the equity trader, and the fixed income trader will have similar tools, information and types of market access subject to the respective nuances in each trading discipline.

Once the securities finance trader is on par with their equity and fixed income colleagues, then perhaps in the near future, mobile applications for the securities finance trader will follow. The trader may reach for his iPad or Droid (not to make a phone call), and with a few finger swipes, process a borrow return, authorise a short sale, book an interest rate swap, place a loan order on a securities lending exchange, and lend a special at a deep negative in the bilateral market. And we will have arrived in the future of securities finance trading technology. **SLT**

John Grimaldi, SunGard
Executive vice president and general manager
securities finance / Loanet

Failure to deliver

In the fifth part of our series on the ICMA White Paper investigating the European repo market, we look at failures to deliver

ANALYSIS

Failures to deliver in a chain of transactions

Market users may find themselves part of a sequence of transactions in which they buy or reverse in securities from one repo counterparty in order to sell or repo them out to another. If the first repo counterparty fails to deliver, the market user may well be forced to fail on the second repo counterparty.

In a chain of repos the compensation in the form of the repo rate paid by the first repo counterparty (A) will offset the cost to the market user (B) of failing on the second repo counterparty (C), so the cost of failing and the incentive to remedy the delivery failure falls on the party at one end of the chain who initially failed (A), while compensation for suffering the delivery failure applies to the party at the other end of the chain who ultimately suffered the delivery failure (C).

In a chain in which a party has a cash transaction on one side and a repo on the other the same principle applies as in a chain of repos - the cost of failing and the incentive to cure the delivery failure falls on the party who initially failed at one end of the chain, while the party who ultimately suffered the delivery failure at the other end of the chain is compensated. In addition, however, the economic position of parties in the middle of the chain is preserved. For example, consider a party (B) who has purchased securities in the cash market (from A) and sold them in the repo market (to C), but suffers a delivery failure by A on the cash transaction, which causes him to fail on his repo with C. On the one hand, he will have to pay the repo rate on his failed repo to C. On the other hand, he will hold a long position in the security on the failed cash transaction, which means that he will start to earn the accrued coupon interest on the security.

Overall, therefore, he will earn the cost of carry (the differential between the coupon and repo rate), which means that he is in the same economic position as if there had been no delivery failure (the difference being that his profit or loss on the position cannot be realised until delivery is eventually made or there is an alternative settlement of claims).

Next, consider the example of a party (B) who has sold securities in the cash market (to C) and bought them in the repo market (from A), but suffers a delivery failure by A on the repo, which causes him to fail on his cash transaction with C. On the one hand, he will hold a short position in the security, which means that he will start to lose the accrued coupon interest on the security. On the other hand, he will earn the repo rate from A on his failedrepo. Overall, therefore, he will lose the cost of carry, which means that he is in the same economic position as if there had been no delivery failure.

Now, consider the example of a party (B) who has sold securities in the cash market (to A) that he is due to receive from a maturing repo (with C), but suffers a delivery failure by C on the repo, which causes him to fail on the cash transaction with A. He will not repay the repo cash to C, but will reinvest it for his own benefit. On the one hand, therefore, he will earn a reinvestment return on the cash. On the other hand, however, he will hold a short position in the security, which means that he will start to lose the accrued coupon interest on the security. Overall, therefore, he will lose the equivalent of the cost of carry, which means, as in previous scenarios, that he is in the same economic position as if there had

been no delivery failure.

Finally, consider the example of a party (B) who has bought securities in the cash market (from C) in order to use them to settle a maturing repo (with A), but suffers a delivery failure by C on the cash transaction, which causes him to fail on the repo with A. He will not get his cash back from A. On the one hand, therefore, he will have to forego the repo rate that he could have been earning on his repo cash. On the other hand, however, he will hold a long position in the security, which means that he will start to earn the accrued coupon interest on the security. Overall, therefore, he will earn the equivalent of the cost of carry, which means that, as in previous scenarios, he is in the same economic position as if there had been no delivery failure.

In summary, it can be seen that the generally-accepted market conventions create compelling economic incentives on parties failing to deliver securities in the cash and repo markets to cure their delivery failures, while parties caught within chains of failed transactions suffer no net economic impact. The economic incentives to cure delivery failures in the repo market do however depend on prevailing interest rates being reasonably positive.

Failure to deliver in low and negative interest rate environments

When interest rates fall to low levels, the economic incentives to remedy delivery failures that are created by the generally-accepted market convention are weakened. If repo rates fall to negative levels, the convention can even produce perverse results. A negative repo rate means that the repo seller (cash borrower) is paid by the repo buyer (cash lender). Therefore, if a repo seller fails at the start of a repo, it is the repo buyer who would have to pay the repo rate and who would be penalised, even though it is the repo seller who has failed. This could encourage repo sellers to enter repo transactions with no intention to deliver, in order to profit from a negative rate (a so-called "strategic fail").

In practice, such abusive behaviour has not been reported in the European market. However, the European Repo Council (ERC) of the ICMA felt it was prudent to remove any incentive for strategic fails. It has accordingly issued a recommendation that, in the event a repo seller failed to deliver in a repo transaction at a negative rate, the repo rate would immediately be reset to zero or the repo buyer could terminate that the unsettled repo. At the moment, this recommendation needs to be agreed by parties before each transaction or incorporated into the documentation governing repo transactions between them.

This would typically be the ICMA's Global Master Repurchase Agreement (GMRA), which is the most extensively used cross-border master agreement for repos. However, the recommendation is likely to be integrated into the standard GMRA when this is revised next year.

Contingent remedies for delivery failures in low and negative interest rate environments

The cash and repo markets have a wide range of additional measures in place that could be employed to deal with widespread delivery failures in exceptional circumstances such as very low or negative repo rates:

A buyer who has suffered a delivery failure in the cash market has the right under conventions sponsored by market bodies such as ICMA (if agreed by both parties before trading and incorporated into the legal documentation governing their transactions) to "buy in" the undelivered securities and charge the additional cost of purchase to the seller. In normal circumstances, the right to buy-in is not employed in major government securities markets. It was designed for corporate bonds, for which delivery is particularly important, given that these securities are often subject to corporate events and because their idiosyncratic structures tend to make them unique. Government securities, on the other hand, are not subject to corporate events and are generally fungible, so failure to deliver is not as problematic as with corporate bonds. As a consequence, the potential cost of a buy-in (the difference between the original price and the buy-in price) is seen as disproportionate in the case of government securities and the threat of buy-ins would probably drive market users to reduce the size of their positions, which would impair market liquidity. However, the right to buy-in is a measure to which resort could be made in exceptional circumstances.

In the repo market, in the case of a failure by a repo buyer to return collateral securities to a repo seller at the end of a transaction, the GMRA gives the repo seller the right to terminate the failed repo or force a so-called "mini close-out" on the repo buyer in respect of the unsettled transaction. A mini close-out is broadly similar in effect to a cash market buy-in. However, in practice, mini close-outs are not used in the repo market. This is because the cost of a mini close-out is much larger than the average earnings from repos. The threat of mini close-outs would skew the risk/return trade-off in the repo market to such an extent that market users would probably scale back their involvement, which would reduce market liquidity. However, like the right to buyin, the mini close-out could be used in exceptional circumstances.

Another sanction available in the GMRA against failure to deliver, which could also be employed in exceptional circumstances, is the right by a party to a repo transaction to treat a failure to deliver as an event of default.

If further measures were felt to be necessary to deter delivery failures in a low or negative interest rate environment, consideration could be given to the introduction into Europe of a new convention under which market users would charge each other penalties for delivery failures in both the cash and repo markets. Such an initiative was taken in the US Treasury securities market in May 2009, although in response to significantly higher levels of delivery failures than have been seen in European markets. The possibility has been considered as a contingency by at least one CCP in Europe.

A "fails penalty" convention would come into play only when interest rates fall to levels where the economic incentives to cure delivery failures under the existing generally-accepted market conventions start to weaken. Penalties would be calculated according to a formula such as: the greater of zero and the difference between a fixed Threshold Rate and a variable Reference Rate. The calculated penalty rate would accrue daily over the duration of the delivery failure in a cash transaction or, in the case of repos, until the earlier of late delivery or the maturity of the repo. The Reference Rate should be representative of general interest rates. It could be a benchmark money market rate or a central bank repo rate. The rationale for this type of formula is that:

Penalties are only needed when general interest rates are very low and would be triggered by the Reference Rate falling below the Threshold Rate. When rates are higher and the Reference Rate is greater than the Threshold Rate, the formula sets to zero (as the difference between the Threshold Rate and Reference Rate would be negative). This means that there would be no penalty for delivery failures in normal circumstances and failing parties would be subject only to the existing economic incentives to cure delivery failures (paying the repo rate in the case of a repo and the accrued coupon interest in the case of a cash transaction).

The formula would produce a sliding scale of penalties, increasing as the Reference Rate fell towards zero, topping up the decreasing economic incentives and setting a floor under the cost of a delivery failure. In the case of repos, assuming repo rates are closely aligned with the Reference Rate, this floor would be equal to the Threshold Rate. For example, given a Threshold Rate of three per cent per annum and a Reference Rate of two per cent per annum, the calculated penalty for a delivery failure would be one per cent (the greater of zero and the difference between three per cent and two per cent. A party failing to deliver at the start of a repo would also have to pay the repo rate of about two per cent making a total of three per cent. If the Reference Rate and market repo rates fell to one per cent, the fails penalty would be two per cent (the greater of zero and the difference between three per cent and one per cent), so a party failing to deliver at the start of a repo would continue to pay a total of three per cent. **SLT**

Dubai Securities Financing Forum

Date: 11 November 2010
Location: Dubai
Website: www.dataexplorers.com

Data Explorers' Securities Financing Forum in Dubai is taking place on Thursday, 11th November 2010. Our Global Securities Financing Forums are known throughout the industry as THE event to attend for insightful analysis that highlights specific challenges and opportunities facing the securities financing market

Amsterdam Securities Financing and Buyside Breakfast

Date: 17 November 2010
Location: Amsterdam
Website: http://www.dataexplorers.com

Join Data Explorers and ISF at the Dylan Hotel Amsterdam for the Securities Financing and Buyside forum

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Date: 13-16 February 2011
Location: Scottsdale, Arizona
Website: http://secure.imn.org

The largest, only must-attend event for the beneficial owner community 450+ attend annually, including over 125 beneficial owners

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Industry Appointments

Societe Generale Corporate & Investment Banking has announced the appointment of **Ashley Wilkins** as deputy chief executive officer for the Asia Pacific region.

Based in Hong Kong, he is a member of Societe Generale Corporate & Investment Banking's Asia Pacific Executive Committee. He will report to Hikaru Ogata, the regional chief executive officer who has been on board since September this year.

Wilkins joined the bank in 1996 as head of project finance & advisory in Asia and in 2007 was appointed as head of global finance, Asia Pacific - a position that he will retain. As deputy CEO, Wilkins will assist Ogata in developing and executing the bank's overall strategy in serving corporations and financial institutions in global markets (equities, fixed income and commodities), financing and advisory as well as in industry sectors where the bank has significant regional expertise (energy, commodities, infrastructure, media & telecoms).

Leveraging his knowledge of the region and the industry along with his expertise in structured finance and his client relationships earned over many years, Wilkins will particularly focus on global finance and client business.

Before joining Societe Generale Corporate & Investment Banking, Wilkins spent over 16 years with NatWest Group in London and Hong Kong in a variety of senior roles in the structured finance division including two years with County Bank, NatWest's merchant banking & capital markets subsidiary in London.

Hamish Anderson has been appointed European sales chief at HSBC's new prime services division. He will be responsible for the bank's prime services business in Europe, as well as expanding the product range in the region.

Anderson will report to Chris Barrow, global head of sales for HSBC Prime Services. He has previously worked at Bank of America Merrill Lynch, Dresdner Kleinwort, Reech Capital and Schroders.

Claire McKinlay has been named business development & marketing associate at EquiLend. McKinlay will be based in New York, NY. In this role, she is responsible for working with existing and prospective clients.

McKinlay joins the company from IMN where she spent five years working to produce their series of Beneficial Owner Securities Lending Summits. Her responsibilities there included: client management, conference agenda production and business development. Claire has extensive experience building relationships with all stakeholders of the international securities finance and hedge fund communities.

McKinlay graduated with a Master of Arts degree in Business from the University of Edinburgh and holds International Business Certificates from the University of Cambridge.

Jefferies have recently hired **Josh Gold** as a managing director and head of the firm's new Hedge Fund Relationship Group. Gold will be responsible for efforts to manage the firm's overall relationships with US-based hedge funds, including representing Jefferies' broad product offering across equities and fixed income.

"The establishment of a hedge fund relationship group is further evidence of Jefferies' commitment to strengthening our equity and fixed income sales and trading platform, and to providing quality, best-in-class service to our global institutional clients," commented Richard B. Handler, chairman and chief executive officer of Jefferies. "Given his strong background, Josh Gold is well-qualified to lead this strategic effort for Jefferies as we continue to focus on our customers."

Gold joins Jefferies from Dematteo Monness, LLC, an independent primary research firm and full-service broker-dealer, where he spent seven years, most recently as a managing partner. Previously, he spent three years at Goldman Sachs, where he started and led that firm's dedicated hedge fund coverage effort in Boston. Prior to that, he worked at Donaldson, Lufkin & Jenrette and Bear Stearns in equity sales capacities. He received a BA from Lafayette College.

Eagle Investment Systems LLC, a subsidiary of BNY Mellon, has hired a new regional sales director to address the business development needs of existing clients and prospects in Europe, Middle East and Africa (EMEA). **Atul Mehta** brings extensive knowledge and experience selling back office systems to buy side asset managers across the territory.

Mehta, responsible for the Middle East region as well as parts of Europe and the UK, joins Eagle from SimCorp where he was most recently a sales manager for the European and Middle Eastern markets selling portfolio management solutions. During his 11-year tenure at the firm, his roles and responsibilities focused on the firm's sales and pre-sales activities and delivering solutions to key clients. Prior to SimCorp, Mehta worked as a client support analyst working with front office clients at Linedata.

As the global financial services markets ready for new regulation such as Solvency II, or make advancements with existing compliance directives like IFRS, legacy data management and investment accounting solutions many times can not comply with the new requirements. The industry move toward more automation and risk management has created opportunities across EMEA and other parts of the world in these areas.

"Eagle continues to attract investment managers across EMEA because its solutions help provide operational efficiencies and risk management in these times of new and changing regulation. Furthermore, Eagle's fastest growing delivery capability, application hosting, has garnered significant interest in this region because today's savvy investment managers want the best technology, without the price tag for maintaining technology and running applications," said John Legrand, Eagle's managing director of Eagle's EMEA operations.

Eagle's recent hiring of Mehta comes on the heels of another recent hire, **John Boggis**, who joined the firm in the first quarter to manage the continental Europe and Scandinavian markets with shared responsibility for the UK region. He also joined Eagle from SimCorp where he was a sales manager for the European region since 2005.

Mehta and Boggis both report directly to Legrand, "While Eagle has expanded into new areas of the world such as the Middle East and Africa in the past few years, we have also continued to engage with many new business prospects across Europe. Each of these markets presents tremendous opportunities, and as such, it became necessary to expand our well-established and world-class operations by adding Atul to the team," said Legrand

SLT SECURITIESLENDINGTIMES

Editor: Ben Wilkie
editor@securitieslendingtimes.com
Tel: +44 (0)20 3006 2710

Marketing: Steven Lafferty
design@securitieslendingtimes.com

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
Tel: +44 (0)20 8249 0235
Fax: +44 (0)20 8711 5985

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Kent
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UK

Company reg: 0719464

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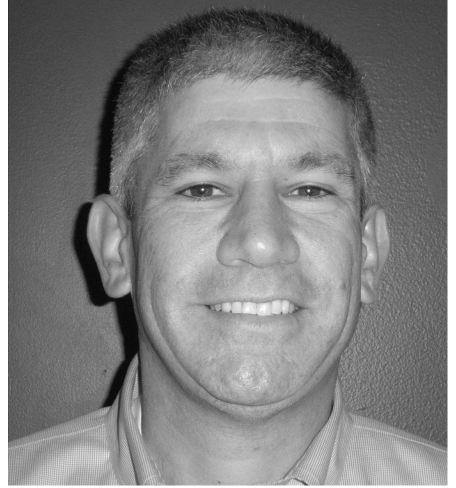
Leonard Bartosik



Meet Leonard Bartosik, an expert in the stock loan operations arena, who is looking for a return to the industry he loves

Tell me a little about yourself

I grew up in Staten Island, and attended St. John's University. I graduated with a Bachelor's degree in 1984, and got a job at Bradford Trust Company. I worked there from November of 1984 until January 1986, at which time I was hired at Goldman Sachs in February of 1986.

I performed many functions in the Global Control area from 1986 until May of 1997. I reconciled money and stock breaks for the whole firm, I balanced and corrected foreign money breaks, I identified firm stock deficiencies and instructed the stock loan area to borrow the stock. In May 1997 I moved to the stock loan operations area, and by 1999 I was manager and vice president of the area. I continued in that capacity until 2006. While there I thoroughly knew all the operation functions including contract compare, mark to markets, rate changes, returns, and collateralising contracts. I represented Goldman Sachs on the operations side in developing Equilend.

In 2006 I moved to the stock loan trading area and worked on covering stock deficiencies and preventing buy ins.

What industry qualifications or relevant certification do you hold?

My experience has given me the understanding of all aspects of stock loan operations, and I am also skilled at managing and hiring the right people.

What was your last position in the industry and what did you enjoy most about it?

I worked on preventing stock loan buy ins. What I liked most about the position was the constant communication with other brokers and banks to identify exactly how much stock was needed on a given day to prevent a buy in. I also liked tracking down the institution that was applying the pressure on a given stock.

What area are you looking to get back into?

I am looking to get back into the stock loan operation side. I feel my strength is in that area with the combination of my knowledge and leadership capability.

What do you feel you could bring to a future role?

I was responsible for working with our IT group to develop new systems and new procedures to deal with the constant changes in the stock loan world. I was an excellent manager who was very good at streamlining and improving procedures.

What do you feel the industry needs most?

I feel the industry needs to communicate clearly from firm to firm and from trading to operations. Everyone needs to be on the same page so we can conduct business smoothly and compliant with all the rules.

Contact Leonard

email: lenlb24@gmail.com

To be profiled please email
justinlawson@securitieslendingtimes.com