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Lending doesn’t forfeit governance

Securities lending does not stand in the way of institutional investors exercising their right to governance on company issues, according to a whitepaper by academics from US and UK universities.

The paper, entitled The Role of Institutional Investors in Voting: Evidence from the Securities Lending Market, charts an investigation into the voting preferences of investors, specifically from a securities lending perspective.

While securities borrowers inherit proxy voting rights and could, in theory, vote in annual general meetings to affect corporate actions, lenders have the right to restrict lending in the run-up to such an event, and to recall securities at any given time.

This is more common practice among investors that have an incentive to monitor and exert governance, but also occurs among investors in firms that are performing poorly or have weak governance, and when returns for voting are likely to be higher, for example, if the vote relates to corporate control.

The paper found that higher share recall correlated with less support for the firm’s management, and more support for shareholder proposals. It noted that investors value their votes, often over the income from lending, but also that loan demand and borrowing fees increased around these record dates.

Generally, investors will keep their recall and proxy voting mechanisms private, however knowing these preferences can be important for firms trying to attract new investment. It can also be important information for policymakers involved in the regulation of governance methods.

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RBC offers collateral stress testing

RBC Investor and Treasury Services has launched a solution to monitor and stress test collateral liquidity.

The solution has been designed to help firms comply with new collateral requirements as prescribed by the European Securities Markets Authority (ESMA).

The ESMA guidelines outline quantitative and qualitative criteria that the Undertakings for Collective Investments in Transferable Securities (UCITS) and UCITS exchange-traded funds (ETFs) must meet when entering into over-the-counter (OTC) derivatives transactions and efficient portfolio management techniques.

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DTCC boosts Omgeo Alert for primes and custodians

The Depository Trust & Clearing Corporation (DTCC) has added new global custodian and prime broker automation capabilities to Omgeo Alert.

State Street is one of five custodians due to go live on the Omgeo Alert Global Custodian Direct service this year.

The release, Alert 5.0, includes the Global Custodian Direct feature, which enables global custodians and prime brokers to electronically maintain timely and accurate standard settlement instruction (SSI) data in the system, on behalf of their clients. Currently, investment managers perform these updates manually.

Global custodians and prime brokers, through adoption of Alert, can offer their clients the additional service of maintaining and providing SSI data in an automated, secure and efficient manner.

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Securities lending doesn't forfeit governance

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The report outlined five key findings: that investors will recall shares in order to exercise voting rights; that not all investors value their vote in the same way; that recall decisions vary depending on the firm in question and the characteristics of the vote; that lenders place a significantly higher value on votes than borrowers; and that share recall is associated with diminished support for management.

It concluded that proxy voting is an important channel for affecting corporate governance, and that investors should be sure to learn about proxy rights in good time before the record date for voting, in order to make an educated decision on whether to lend or not, and whether to recall shares.

The paper's authors wrote: "Thus, our results are consistent with shareholder voting acting as an effective governance mechanism, but only when the economic stake is large enough or economic benefit great enough to overcome the free-rider problem that arises from the dispersed ownership."

The report was completed by Reena Aggarwal of the McDonough School of Business at Georgetown University, Pedro Saffi of the Judge School of Business at the University of Cambridge, and Jason Sturgess of the Driehaus College of Business at DePaul University.

RBC offers collateral stress testing

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The purpose of the requirements is to reinforce investor protection and transparency, mitigate counterparty risk and harmonise regulatory practices across Europe.

RBC Investor and Treasury Services's Collateral Risk Report will provide assistance to clients by monitoring and measuring the eligibility and diversification of collateral received in relation to OTC transactions and efficient portfolio management techniques.

The tool will also provide liquidity stress testing whenever a fund's aggregated collateral exceeds 30 percent of the fund's net asset value, in accordance with the ESMA guidelines.

Joanna Meager, global head of client operations and head of RBC Investor and Treasury Services UK, said: "New regulations are driving clients to reconsider the way they manage their collateral and associated reporting processes."

"Our Collateral Risk Report helps users to meet these evolving requirements while optimising operational efficiency, mitigating risks and reducing costs."

DTCC boosts Omgeo Alert for primes and custodians

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The service also facilitates the communication of custodian-sourced, market practice-compliant data by connecting a custodian's central SSI repository to the Alert host, using ISO 20022 standard messaging.

"Asset managers have traditionally maintained SSIs for their accounts, however, custodians have always been the source of this data, where each account settles and holds its assets. Omgeo created Alert to enable asset managers to maintain their SSIs in a central repository for brokers to access, driving value for these segments," explained Bill Meenaghan, executive director of Alert product management at Omgeo.

"By adding custodians as users of Alert, we will be able to improve information quality standards, since custodians will automatically be updating their data as they create or change account standard settlement instructions."

Dick Taggart, a member of the Omgeo board of managers and executive vice president at State

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Street, who also serves as chairman of DTCC's SSI utility product governance committee, said: "By enabling global custodians to access and update Alert automatically via GC Direct, we add significant efficiency and risk reduction to the industry."

"SSIs will be more complete and accurate, which helps reduce fail risk, and Omgeo's establishment of a true utility under the DTCC umbrella reduces costs and risk for all subscribers and participants."

Subsequent phases will expand asset class coverage in the service, as well as offer an enhanced application program interface for brokers, asset managers and third-party transaction services to retrieve SSI information in real-time during trade processing.

Banque Pictet & Cie uses Calypso system

Geneva-based Banque Pictet & Cie has chosen the collateral management solution from software provider Calypso Technology.

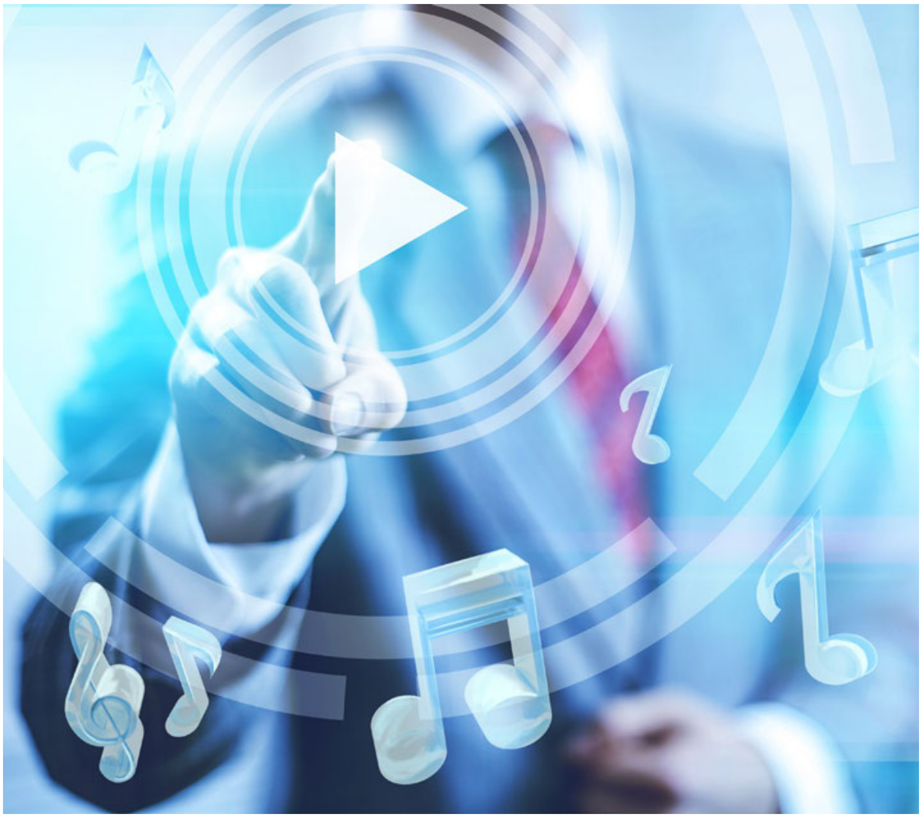
The system will consolidate the bank's collateral activities to one platform across various businesses, creating a centralised management system that can aggregate collateral pools from its core system for processing margin cells. It will be implemented to manage both internal collateral and client collateral.

As of December 2014, Pictet has assets under management and custody totalling about €435 billion, and customers including institutional asset managers, funds, family offices and other banks.

Implementing the new system is part of a move away from manual management systems, and represents a more scalable solution for growing business and associated customer agreements.

It will also help Pictet to meet new regulations that require initial margining for listed and OTC contracts.

Calypso was reportedly selected for its ability to meet the functional requirements of the bank, as well as for its ability to connect core banking systems to key downstream systems such as confirmations and messaging.



Short sellers hit Pandora as streaming intensifies

Short sellers are targeting online music streaming service Pandora as the content war heats up, according to Markit.

With new entrants such as rapper Jay Z's Tidal music service making the streaming market more competitive, short sellers are surrounding Pandora, one of the first services in the business.

The proportion of shares outstanding on loan for Pandora has increased 35 percent in the last three months and now stands at 9.5 percent, a multi-year high for the company.

The surge in demand to sell the company short comes after its shares fell more than 40 percent in the last 12 months.

Video streaming service Netflix, meanwhile, has not suffered the same fate, seeing shares outstanding on loan decrease to multi-year lows of 2.3 percent.

"This covering comes as investors' questions about Netflix's business model have largely been answered as the firm successfully switched its business model to streaming and started to create its own content," explained Markit analyst Relte Schutte.

Clearstream continues 2015 growth spurt

Clearstream's global securities financing business has sustained its growth throughout 2015, recording an 11 percent increase compared to March last year.

The combined services of triparty repo, securities lending and collateral management reached an average outstanding of €653.2 billion in March, 11 percent more than the €587 billion in March 2014.

Year-to-date the average monthly outstanding has grown 8 percent to €628.4 billion, compared to an average of €580 billion last year.

Clearstream's investment fund services also increased 34 percent to reach one million transactions, and assets under custody increased 12 percent, reaching €13.5 trillion, compared to €12.1 trillion in March 2014.

Philip Brown, a member of Clearstream's executive board and head of global client relations, commented: "Our latest set of monthly numbers display that the positive trend in business volumes from January and February has been sustained through March."

"We are extremely grateful to our clients for the trust they show in us, and will continue delivering to them the market-leading service with which we have become synonymous."

OCC announces 6 percent decrease in volumes

OCC's total cleared contract volume in March stood at 341,593,001 contracts, representing a 6 percent decrease from the March 2014 volume of 362,379,835 contracts.

The year-to-date average daily cleared contract volume is down 9 percent from 2014 with about 16.5 million contracts.

Stock loan activity at OCC in March was up 17 percent from March 2014.

Exchange-listed options volume reached just over 337 million contracts in March, a 5 percent decrease from March 2014.

Average daily options volume at OCC in 2015 is down 9 percent from 2014 with 16.28 million contracts.

Equity options volume in March 2015 reached 308.21 million contracts, a 4 percent decrease from March 2014. Index options volume for the month was down 15 percent with 28.83 contracts.

OCC's cleared futures volume in March 2015 was 4.56 million contracts, a 33 percent decrease from March 2014.

Year-to-date average daily cleared futures volume at OCC is down 25 percent from 2014 with 224,309 contracts.

OCC's securities lending central counterparty activity was up 17 percent in new loans from March 2014 with 114,342 transactions during the month.

Year-to-date stock loan activity is up 10 percent from 2014 with 317,464 new loan transactions in 2015. The average daily loan value cleared by OCC in March was jut over $175.2 billion.

Eurex volumes up for 2015

Trading volumes at Eurex Exchange grew 10 percent in Q1 2015, while March's figures revealed an increase in repo trading in the majority of areas.

Eurex Repo, which operates the Euro Repo and GC Pooling markets, recorded an average outstanding volume of €208.8 billion in March, increased from €190.2 billion in March 2014.

The secured money market GC Pooling reached an average outstanding volume of €169.5 billion, a 13 percent increase from the March 2014 total of €150.1 billion.

The Euro Repo market, however, reached an average outstanding of €39.3 billion, reduced slightly from €40.1 billion in March last year.

In March 2015, the international derivatives exchanges reported an average daily volume of 9.6 million contracts, compared to 9.4 million in March 2014.

Of these, 7.3 million were Eurex Exchange contracts, an increase from seven million in March 2014, and 2.3 million were traded on the US-based International Securities Exchange (ISE), reduced slightly from 2.4 million.

In total, March 2015 saw 159.8 million contracts traded at Eurex Exchange and 50 million traded at the ISE.

In the equity index derivatives segment, Eurex reached 79.1 million contracts, an increase of 14 percent on March 2014's total of 69.4 million.

The interest rate derivatives segment increased from 50.4 million in March last year to 51.1 million this year, and the equity derivatives segment reached 27.9 million contracts, an increase from 26 million in March 2014.

Of these, 16.9 million were equity options and 11 million were single-stock futures.

Clearstream opens Zurich base

Clearstream has opened a new representative office in Zurich.

The new location is part of Clearstream's strategy to extend its global presence and to better serve clients based in Switzerland and the surrounding region, and allows it to strengthen its ties to local markets.

Positioned to complement the network of offices around the world, the new location will be managed by Marco Geisselhardt, head of relationship management for Clearstream's investment fund services.

Geisselhardt said: "The opening of a representative office in Zurich allows us to best serve our growing number of clients with large fund portfolios in Switzerland and Liechtenstein."

Philippe Seyll, a member of the executive board and head of investment fund services at Clearstream, added: "The opening of the new Zurich office is part of our strategy to extend our global network and to have a local presence in key investment fund centres around the world."

"The strong growth of investment fund assets is further strengthening Vestima's role as the leading international fund market infrastructure for all types of funds."

'Lacklustre' March for US pension plans

The funded status of typical US corporate pension plans fell 0.4 percentage points in March 2015, declining to 87.2 percent, according to the BNY Mellon Investment Strategy and Solutions Group (ISSG).

According to the BNY Mellon Institutional Scorecard, public plans, endowments and foundations all missed their targets for the month as asset classes lost value.

For the typical US pension plan, assets decreased by 0.5 percent in March, and liabilities fell by 0.1 percent as the Aa corporate discount rate rose by 2 percentage points to 3.86 percent.

These liabilities are calculated using the yields of long-term investment grade bonds, with higher yields on bonds resulting in lower liabilities.

Compared to the same point in 2014, funded status has fallen by 4.9 percentage points, and by 0.1 percentage points compared to the beginning of 2015.

According to the ISSG, public defined benefit plans missed their return target by 1.3 percent in March, as assets had a negative return of 0.7 percent. Year-on-year, public plans remained below their target by 2.7 percent.

For endowments and foundations, the final return in March was negative 1.1 percent, as assets returned negative 0.9 percent. Year-on-year, they are missing their inflation plus target by 2 percent, according to the ISSG.

Andrew Wozniak, head of fiduciary solutions at the ISSG, said: "March was a lacklustre month for most markets, with little fluctuation in asset values."

He added: "However, volatility increased as investors anticipate a shift in US monetary policy."

"Higher rates would reduce liabilities, although investors would have to decide where to allocate assets so they are best positioned in the new interest rate environment."

Negative capital movement in April for SS&C

The gross return of SS&C GlobeOp's Hedge Fund Performance Index for March 2015 measured at 1.3 percent. This figure is down from 2.19 percent in the previous month.

Hedge fund flows as measured by the SS&C GlobeOp Capital Movement Index declined 1.14 percent in April, down from a 0.66 percent advance in March.

SS&C GlobeOp's data on the GlobeOp platform represents approximately 10 percent of the hedge fund industry.

"The negative capital movement index for April reflects the typical seasonal pattern," said Bill Stone, chairman and CEO of SS&C Technologies.

"There was a slight decline compared to last April's results, which occurred despite lower outflows this year, as a drop in new contributions outweighed this. So far in 2015, the overall trend suggests stability in allocations to hedge funds."

Cumulatively, the SS&C GlobeOp Capital Movement Index for April 2015 stands at 146.44 points. The index has declined 2.12 points over the past 12 months.

SunGard's hottest stocks

SunGard's Astec Analytics has compiled the hottest stocks from around the globe for the week beginning 6 April 2015.

Anglo-Swiss miner and commodity trader Glencore (GLEN.L) is Astec's top pick for Europe, the Middle East and Asia (EMEA) after it said it would stop funnelling sales from its Australian coal operations through its Singapore office, amid growing concerns in Australia surrounding corporate tax avoidance by large mining multinationals.

While its share price underwent some "choppy" trading during the week, data from Astec suggests short selling has been on the rise for more than a month, with the number of Glencore shares being borrowed now 58 percent higher than the same time last month.

Also in the EMEA, Transocean's (RIG) share price managed to hold on to much of the gains made earlier in the month, while on the borrowing front Astec's data shows the first minor reduction in volumes for more than a month, at a 3 percent fall in the week, still leaving levels 13 percent higher than 1 March.

Tech giant Apple (AAPL) is Astec's top pick for the Americas as its new smartwatch became available to pre-order before the 24 April launch date. With consumers expected to wait a month for delivery amid strong demand from enthusiasts, with estimates that as many as one million units had been pre-ordered on the day.

"Apple's share price generally gained ground during the week, though our data hints that this may have spurred some interest from the short side—borrowing volumes climbing about 20 percent during the week."

Elsewhere in the Americas, 3D Systems Corporation (DDD) continued to draw focus.

In the cash market, its share price made gains during the week, for a total increase of almost 9 percent in April so far, while on the borrowing front there are some early signs that demand to short sell may be tapering.

The cost of borrowing eased back from about 29 percent to 25 percent during the week, while the number of shares being borrowed held steady.

In the Asia Pacific region, commodity trader Noble Group (N21.SI) has seen bad press damage its share price in the cash market, though its strong refute helped the stock recover most of these losses by the end of the week.

That said, data from Astec hinted at growing short selling activity for the past four weeks, in which time the number of shares being borrowed has climbed 44 percent.

Finally, Hanergy Thin Film Power Group (0566.HK) has continued to see attention after it said it would be producing solar panels that will be used on various catering and recreational vehicles, through cooperation with mobile kitchen maker Shandong Taian Changan.

Astec commented: "While its shares saw some mixed trading in the cash market last week, the securities lending figures suggest short sellers may have been turning more bullish on its prospects, with borrowing volumes falling by some 50 million shares in just a few sessions, now down about 9 percent since this time in March."

€1.7 trillion securities on loan in 2014

The International Securities Lending Association (ISLA) has found that €1.7 trillion of securities were on-loan globally as at 31 December 2014, drawn from an available lending pool of €12.5 trillion.

This represents a growth of some 18 percent in reported on-loan balances during 2014, according to the second edition of the ISLA's Securities Lending Report, which aims to provide policymakers with accurate industry statistics.

As of 31 December 2014, ISLA found that institutional investors such as pension funds, mutual funds and sovereign wealth funds, remained the largest participants in the securities lending market.

Banks' securities lending, when acting as principal, represented 23 percent of the market, up from 18 percent in June 2014.

Fifty-two percent of all outstanding loans were of equities or exchange-traded funds, which was broadly the same as at 30 June.

The ISLA report has also shown that government bond lending represented 38 percent of the total global on-loan balances by year-end 2014, up from 35 percent at 30 June, with both the supply and demand to borrow government bonds increasing during 2014.

The report stated: "The split between non-cash and cash collateral received by lenders was broadly 55/45 with a clear and ongoing drift away from cash collateral."

"In certain markets such as government bond lending this trend was more extreme with, for example, only 10 percent of loans of European government bonds being booked as cash collateral loans."

From a regulatory point of view, the impact of prudential and derivatives reforms (in particular through Dodd-Frank in the US and Capital Requirements Directive IV and European Market Infrastructure Regulation in Europe) are having a "material impact" on the terms on which borrowers are prepared to do business, according to ISLA.

Some of the predicted trends towards the more efficient use of collateral through term non-cash collateralised structures, which support better liquidity coverage ratio calculations, are now being seen in practice within the data.

China to allow short selling

China has decided to allow fund managers to lend shares for short selling, and also intends to expand the number of stocks investors can short sell, according to reports.

The country's shares also posted seven weeks of gains, reaching seven-year highs, as retail investors moved to borrow a record amount of money to buy shares.

Although investors can only currently short sell 900 classifications of stocks, the options will soon expand to 1,100.

Earlier in the year, the Shanghai Stock Exchange (SSE) released guidelines to promote the development of the bond market and increase the liquidity of various bonds and asset backed securities (ABSs).

The SSE's existing collateralised repurchase of bonds adopts the trading settlement mechanism of auction and guaranteed delivery, and takes the standard bond system for accounting of the value of pledged bonds.

The SSE stated that this will further improve the market infrastructure, promote innovation in trading products and trading mechanisms of bonds, strengthen the investor protection mechanism, and promote the steady development of the bond market.

A focus on regulation

Avoiding the pitfalls of BCBS239 compliance

If they have not already started, domestically significant investment banks (D-SIBs) should start working on their BCBS239 compliance strategies immediately if they are to avoid the difficulties experienced by their G-SIB (globally significant investment banks) counterparts.

The Basel Committee on Banking Supervision published its second report in January 2015 charting the progress made by G-SIBs in their attempts to comply with its principles for effective risk data aggregation and risk reporting. The report revealed mixed results, with almost half of G-SIBs questioned admitting they will be unable to comply with at least one of the 11 banking principles by the 1 January 2016 deadline.

The spotlight is now shifting to the D-SIBs and their respective efforts towards compliance. Under the guidelines set, D-SIBs are not required to implement BCBS239 by January 2016. However, the Bank for International Settlements (BIS) recommended that regional regulators apply a three-year timeframe, starting from when the individual organisation is designated as a D-SIB. Since the regulators' recognition of D-SIBs is not a globally synchronised process, there is a somewhat blurred timeline, but the D-SIBs know who they are, and have begun or are beginning to budget, plan and mobilise their BCBS239 programmes.

Starting from scratch and with three years to implement, D-SIBs should be able to take advantage of the experiences and lessons learned by the G-SIBs—many of which were learned the hard way. They can avoid the costly mistakes of many G-SIBs by using their time and budgets more efficiently and ensuring that appropriate tools, data models, processes and other accelerators are utilised. D-SIBs can also reduce project risk and aim for a quicker and better quality end result.

Moreover, D-SIBs that seize the opportunity to get it right the first time will also be able to avoid the near-ubiquitous tactical mitigants and manual processes found in the approach of the G-SIBs. Then they can focus on strategic build, rather than burden themselves with costly technical and process debt for years to come.

In sharp contrast to the majority of G-SIBs, it is even possible that some D-SIBs will realise the gains in efficiency, reduced probability of losses, enhanced strategic decision-making, and increased profitability cited by the BIS as the core benefits of improving their risk data aggregation capabilities.

The challenges and problem characteristics for D-SIBs are of course different from G-SIBs. D-SIBs are smaller and typically less complex than G-SIBs, with fewer distinct entities and source systems. This means the scale of the challenge and associated costs are reduced and in principle at least, more easily managed. On the other hand, there still is a significant, minimum programme and infrastructure investment cost even for D-SIBs, which will also generally be more sensitive to budgetary pressures and cost of ownership. Smaller D-SIBs will also not necessarily have on hand the large regulatory change and execution teams to implement the programme.

Those D-SIBs that undertake their BCBS239 programme with a more strategic approach, and which pay close attention to the lessons learned by the G-SIBs, should be able to reduce risks and project costs, and achieve not simply compliance, but an integrated risk aggregation platform which adds real value. The challenge for the D-SIBs is whether they can act quickly enough, embrace BCBS239 and take full advantage of opportunities it presents.

Tony Sodhi
Principal consultant

GFT

www.gft.com

The fall of the middle man

Armed with its new product, OneChicago's David Downey says that securities lending customers will soon be able to meet the same demands as before, with the luxury of cutting out any intermediaries

STEPHEN DURHAM REPORTS

What new products is OneChicago currently working on?

In conjunction with our securities lending focus, we are rolling out short-term, weekly contracts. There are two features to these contracts that make them unique. First, the weekly futures are listed and expire daily. In other words, on each day there is a future being listed that morning (and set to expire in one week) and a future expiring that afternoon (that was listed a week ago).

The second feature of these contracts is that upon expiration, they settle into cash the next business day, on T+1. Parties who are looking to transfer their stock can use our product to do so and simultaneously enter into an exchange-traded derivative that replicates a total return swap. They can carry that position, in a centrally cleared way, completely protected by the guarantees of the Options Clearing Corporation (OCC) and the National Securities Clearing Corporation (NSCC).

Current securities lending transfers are conducted through the Depository Trust Corporation (DTC), which is not a central counterparty (CCP). Critically, this means that they do not guarantee performance between the two parties and that is what leads to failures to deliver.

As you can see, the two features that we can offer are completely absent from the current securities lending world. Going through the OCC and NSCC guarantees performance, as there has never been a failure to deliver through its process. And the trading is done in a competitive transparent manner. These combine to make this is a better way.

There has been a lot of talk about the securities lending market not being able to use CCPs, and the reason is because they do not handle bilateral transactions. The way we function is cheaper for clients, acts to upgrade counterparty exposures for everybody and allows people to act independently of each other inside a regulated, transparent, CCP-protected exchange.

What prompted this and how do you anticipate it will affect business?

The prime brokerage space deals with hedge funds, which are looking for leverage and financing. They get this by using swaps, but can also do this with a future. A single stock future (SSF) is a total return swap, but it is transparent and regulated—which is what scares the firms, as they make a lot of money due to the lack of transparency in these markets.

The volatility in the rates indicates that there is no efficiency in those markets, and prime brokers have always been wary that, if customers begin to use a transparent market, then their profits will be compressed.

This also means that the prime broker intermediaries could be at risk of being pushed out of the marketplace.

In the last 20 years, intermediaries have been gradually phased out with the technological revolution in which buyers and sellers, and lenders and borrowers, can interact in real time, using electronic access.

Securities lending is no different. The only markets that are yet to move this way are the equity markets, and that is where we stand. We maintain, as a substitute for an equity swap, market participants should be using securities futures, which are economically identical to a total return swap.

I have no doubt that, as the new world characterised by Basel III comes into being, people will be looking for new ways to accomplish these critical market processes—and will turn to exchange-traded products to do that. This is where OneChicago stands.

We have used feedback from regulators and customers, and lessons from the events of the late 2000s to shape our contracts.

Has there been any improvement in the uptake of SSFs in recent months? If so, what is to thank for this?

Equity derivatives have generally been depressed across the board, the only one that has done well in the US is the interest rate markets. The fact is that the product has maintained its momentum, it's just not growing in leaps and bounds. Again, we are yet to break into the real market—securities lending will eventually move onto an exchange with CCPs, and that is what we are waiting for.

There is something of a lull in the marketplace overall at present, particularly in terms of stock loan borrow activity. Everyone is going through structural changes and this is affecting liquidity in the marketplace. However, this will come back—the markets always come back.

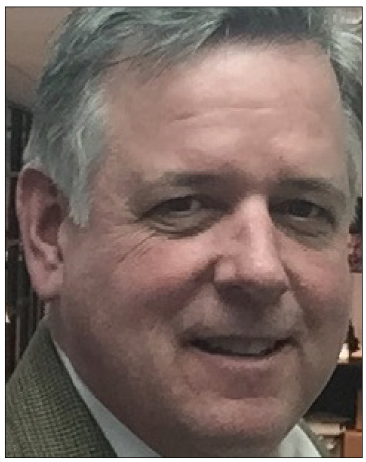
In particular, the use of the SSF based on exchange-traded fund underlyings have been very popular of late, as customers are able to get leverage and financing for whole sectors of the marketplace and not just one stock.

What deterred people from using SSFs in the past? Is this attitude likely to shift in the future?

The only way to get access to SSFs is through an OCC member, and those are primarily the prime brokers.

As I discussed, prime brokers make their money by putting customers into total return swaps and charging them for their balance sheet usage. SSFs are competitive in nature, and in order to get access, one of the prime brokers must allow it—generally, there are exceptions, none of them currently allow their customers access to the product.

This is because it competes with the way they make money, in a non-transparent manner. We believe that they will come to the realisation that customers can fulfill their trading needs inside the safety of a regulated exchange, protected by a CCP, with the luxury of being able to cut that middle man out of the equation. **SLT**



David Downey
CEO
OneChicago

Seasons of securities

France is by no means a mere observer in the EU's securities marketplace, but for now, it may be that slow and steady wins the race

STEPHANIE PALMER REPORTS

It's that time of year where, in the French Alps, the snow has all-but melted and resorts are shuttering up for the season. Traditionally though, things are also getting heated in the securities lending utilisation charts. The last three years have seen their peaks in utilisation levels in May, quickly followed by a steep drop. Generally, they're in the bottom of the valley by July.

At the beginning of 2014, specifically, the amounts of securities available and the demand for borrowing rose at a similarly steady rate, but as availability plateaued—or rather, met with more regular, relatively small, peaks and troughs, the demand to borrow met with a relatively steep slope followed by a steady recovery in the months that followed.

Reflecting this, utilisation saw its high in May and its crash in July, and it was not until September that the figure started to creep upwards again. The graph saw another peak at the end of the year, but it was not to be sustained, and the figure was dragging again by the time 2015 was underway.

It might appear volatile, but 2014 did mirror the utilisation seen in the past two years, at least to an extent. In both 2012 and 2013 there was a spike around May, and another smaller spike towards the end of the year. For these two subsequent years, the lowest point came just after this second spike.

This repeated pattern points to a seasonal effect, most likely linked to the ebb and flow of the market, rather than any external factors. What makes 2014's figures a little different is that the peaks are falling short while troughs don't dip quite as low—the gap between the highs and lows has lessened significantly.

In 2012 and 2013, the springtime utilisation peaks topped out at around 17 percent, before tumbling back to 12 percent in 2012, and to 9 percent in 2013. The second peaks reached just over 10 percent, and about 13 percent, respectively, and both years, the lowest point of utilisation was about 5 percent.

For 2014, both the first and second peaks reached close to 13 percent, before falling to about 7 percent and 9 percent, respectively. The lowest point of the year fell in September at just under 7 percent.

This relative steadiness could be attributed to the increase in borrowing, and to a general flurry of activity in the European market as a whole. In turn, this has been caused, at least partially, by the political volatility in the EU.

In the aftermath of the Greek elections, the region has been rocked by the possibility that Greece could leave the EU, and, according to Mark Loomes, a market analyst at SunGard, this has led to increased activity in the market.

"France has broadly seen some concerns growing on the back of the potential Greek exit, which has translated into greater activity in the securities lending market—particularly with sovereign bonds, which have seen borrowing volumes climb about 125 percent since January 2014."

That said, this unrest is a mere blip in comparison to the upheavals of the past, specifically, the global financial crisis in 2008. According to Loomes, France is making a comeback, even if it isn't outpacing its peers at this point.

He says: "Since 2008, we have seen greater securities lending activity returning across the board, and though France is no different, it is also fairly middle-of-the-road in this regard."

"Growing confidence in the financial markets has spurred greater reinvestment activity, while on the other hand increased short selling in the equity markets has also brought about the need for increased borrowing."

"Last year's dividend season also saw some of the highest borrowing volumes in recent years for the country, though it is still a little too early to see how this will pan out in 2015."

In the current market, as the demand to borrow increases at a fast-but-steady pace, there is plenty of supply to cater to the appetite, and, as seen, the utilisation of securities is essentially following the same trends as the last few years. However, according to Anne-France Demarolle, head of liquidity management services for Societe Generale Securities Services, there could be at a steep incline in demand in the coming months.

She says: "We expect a surge in demand when all collateral requirements on over-the-counter (OTC) derivatives will be fully enforced."

Under the new European Markets and Infrastructure Regulation (EMIR) rules, OTC derivatives will require more collateral, and will therefore be more expensive. This, Demarolle suggests, could lead to derivatives businesses borrowing additional securities to cover the new costs.

Historically, however, while the regulatory landscape has been volatile, and has probably affected all financial services markets, it can be difficult to judge the knock-on effect that individual changes have in real terms.

Loomes says: "It has been the case for the past few years that the growing complexities of the regulatory environment, and the uncertainties that regulations bring, have been dominating much of the talk and operations of financial insiders."

"That said, associating any trends within the market directly to these changes is somewhat of an impossible task, and I suspect the true extent of their impact will only be seen when we look back with hindsight in some future date."

Despite her predictions on EMIR, Demarolle points out that some issues anticipated by the industry don't actually come to fruition, although she notes that it can be dangerous to assume that they won't, and in fact, effects from regulation can work both ways.

"One could have feared that some of the new regulations like the ESMA guidelines for UCITS funds would weigh on securities on loan, due to the requirement to have the appropriate stress-testing policy in place when a UCITS receives collateral for at least 30 percent to its assets. In fact, this didn't materialise as the asset managers adapted their framework in time."

"Now, some recent guidance issued by the French local regulatory authority could have an impact on the way securities lending is conducted by asset managers."

France's market is one with sticking power, and while it has its fluctuations and may not be ahead of the European pack, it is certainly not lagging behind. While the regulatory landscape has the potential to knock market players off-course, last year's utilisation figures show that, so far, they've got the reslience to see it through.

"There are two sides to every coin," explains Demarolle.

"Each new regulation brings additional requirements to be complied with, which translates into additional costs for both providers and beneficial owners."

"On the other hand, the new regulations contribute to demystifying what securities lending is, by providing more transparency on their use, their market participants and details of the trade. This will enable risk managers to be more comfortable with the product."

Greater trust can only lead to more effective community, and while France may be in the midst of a low season, just like in the Alps, there's always another peak on the horizon. **SLT**

Shorting patents

The US patent system is being exploited to drive down pharmaceutical share prices. David Lewis of SunGard's Astec Analytics reports

It feels like very old-world economics to describe the investment cycle for a business—invest in a concept, develop it into a reality that can be used, and more importantly, bought by consumers. It is vital to that investment process that the invention, be it a product or a service, can be protected from imitators—hence the patent system. Just ask Sir James Dyson of Dyson vacuum cleaners fame, or any pharmaceutical company. Don't ask Charles Holland Duell, commissioner of the US Patent and Trademark Office between 1898 to 1901, who is believed to have stated: "Everything that can be invented has been invented". Although, many argue he was badly misquoted.

Without the protection of patents and trademarks, advancements cannot be protected and investments recouped, or to be a little more modern, "monetised". It follows, therefore, that the patents a company employs potentially become very valuable assets, every bit as valuable as buildings or ships are to other companies. The patents on medicines, in particular, can be worth billions of dollars in protected revenue.

Without such protection, generic drugs flood the markets and margins are crushed, typically when patents, which commonly provide time limited protection, expire. Patents, it can be argued, protect excessive profits, but 'big pharma' would counter that without big earnings on some leading products, there would be no investments available to develop new drugs that are tried and tested. Few would weep for big pharma, but without them, where would developments in medicine be?

Short interest, and shorting securities in general, regularly come under the ethical spotlight, often dragging securities lending into arguments: is it ethically right to short a company's shares and make money from them losing value? There are multiple arguments on both sides of this question, but it is hard to avoid the facts that the ability to take a negative position on a security provides for better pricing and less risk of inflated asset values.

There are also many instances of hedge funds highlighting weaknesses in companies, or indeed outright fraud, such as in the recent case of Lets Gowex (GOW.MAC) in Spain, but what if those weaknesses were say, procedural or administrative rather than structural or even fraudulent? Does that make it unethical or simply opportunist?

While some do object to investors making returns from falling share prices, faced with the real statistics, few can really claim that a hedge fund has done more than astutely pick an over-priced asset and benefit when the price corrects. It takes significant capital to be able to drive a price in a desired direction and 'buck the market', and indeed such activities can bring disproportionately high risk of the price going against the bets made. But what if there was a way to legally damage the profitability of a target company, short the shares and ride the inevitable fall? A recent trend of challenging the validity of patents in the US is one such strategy that has raised some alarm regarding the way some hedge funds have sought to take on large public companies in a bid to gain from a falling share price.

In 2012, US Congress created a process to allow cheap and easy challenges to be lodged, designed to counteract what it believed was an excess of patents being awarded. However, this process is now being used by hedge funds to challenge the validity of patents held by pharmaceutical companies—some of which protect multi-billion dollar revenue streams. Companies that have been targeted include Allergan (and its patent for a glaucoma drug, Combigan). Another target was Acorda Therapeutics, which had two of its five patents, which protect 91 percent of revenues, attacked. On the filings made on 10 and 27 February, the share price dropped 9.7 percent and 4.8 percent, respectively.

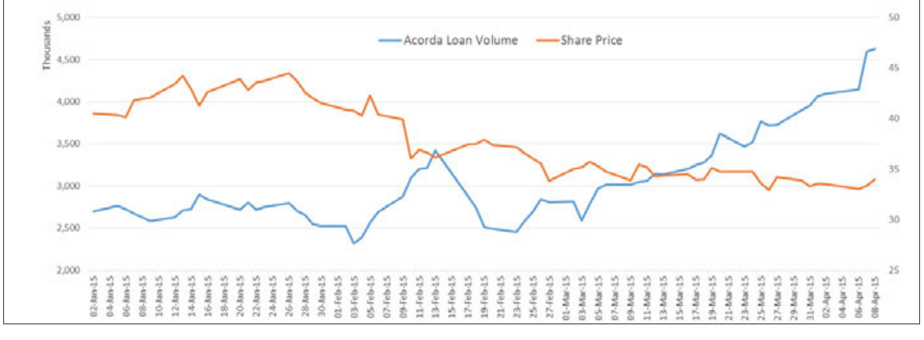
Figure 1 shows the borrowing volumes for Acorda Therapeutics from the start of this year. Borrow volume spiked up at the start of February, rising almost 50 percent to its second highest level for the last 12 months. Positions fell away again by a very similar value by 23 February, before a further climb of about 20 percent ahead of the second filing on 27 February. In each case, the price dropped away on the date of the relevant filings. In simple monetary terms, around one million shares were borrowed ahead of the 10 February filing, which coincided with a $3.85 per share price fall. Filings cost $23,000 to make, suggesting that this is a very lucrative strategy indeed.

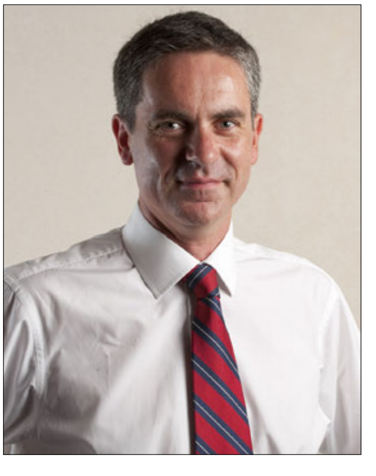
More than 3,000 patent petitions have been filed since September 2012—1,675 of those in 2014 alone. However, it should be noted that only 12 percent of those related to medical actions, and the bulk of those were filed by producers of generic drugs looking to end patent protections early, if they can.

The hedge funds making these filings have protested that their actions are entirely related to removing inappropriate patents that are protecting inflated prices of drugs that people need to purchase, yet cannot readily afford. This is indeed a laudable endeavour, and a defence that may well stand up. However, the hedge fund that filed a petition against Allergan has been quoted as stating that it sees "multiple pathways to monetisation".

Whether this strategy is indeed an altruistic effort to bring down the allegedly overly expensive costs of some patent protected drugs, or a determined way to drive share values downwards for investment gain, is very difficult to say, but it has certainly got the attention of Congress, which is revisiting its plans for this process. Charles Holland Duell may well have been wrong about how much was left to invent after 1899—he was certainly wrong about the inventiveness of some firms when it comes to making money. **SLT**

Figure 1





David Lewis
Senior vice president
SunGard's Astec Analytics

Industry Events

5th Annual CASLA Conference on Securities Lending

Date 3 June 2015
Location: Toronto

CASLA, the Canadian Securities Lending Association, was created with a mission of ensuring the long-term viability of the Canadian securities lending industry by establishing a unified voice.

24th Annual Securities Finance and Collateral Management Conference

Date: 23-25 June 2015
Location Lisbon

Please join ISLA at their 24th Annual Securities Finance and Collateral Management Conference that will take place on 23-25 June 2015 at the Epic Sana Hotel in Central Lisbon, Portugal.

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Industry appointments

State Street has appointed **Alex Lawton** as senior managing director and head of securities finance for Europe, Middle East and Africa (EMEA).

Lawton will be responsible for developing the securities finance business across the region whilst helping State Street's clients to navigate the evolving regulatory framework.

He will report to Rajen Shah, head of State Street Global Markets for EMEA and Lou Maiuri, global head of securities finance.

Prior to joining State Street, Lawton served as head of equity finance and equity prime services for EMEA at Barclays.

He has held other senior roles including head of prime brokerage for EMEA at Bank of America and global head of structured equity trading at Dresdner Kleinwort.

Maiuri commented: "Lawton's experience will be a great asset as we continue to develop our securities finance business. [His] appointment is testament to our continued focus on this important market segment."

Lawton succeeds Don D'Eramo, who after five years of heading up the securities finance team for EMEA, has decided to return to North America at the end of June 2015.

Robert Sackett is joining Wells Fargo Prime Services as head of securities lending.

Sackett is moving to Wells Fargo from TradeStation, where he was senior managing director and co-head of the prime services division.

He moved to TradeStation to set up and lead its securities lending operation in 2011. Before that, Sackett was a managing director at Citigroup Global Markets, where he spent more than 15 years.

The hiring of Sackett follows the additions of Kira Bazile, Kelly Marsch and Paul Schultz to the Wells Fargo prime services sales and capital introduction groups in March.

Wells Fargo also recruited Wendy Beer and George Jamgochian in February.

Citi has appointed **Adam Herrmann** as global head of prime finance.

In his new role, Herrmann will be responsible for all aspects of Citi's prime finance platform including principal and agency securities lending, prime brokerage and delta one in partnership with equities.

Previously, he served as co-head of global equity finance at UBS, including responsibility for both sales and trading across stock loan, equity financing, exchange traded fund market making and delta one.

He will report to Okan Pekin and initially will be based in London. He will relocate to New York by the end of 2015.

BCS Financial Group has recruited **Vyacheslav Smolyaninov** as chief strategist and deputy head of equity research.

Prior to his new role, Smolyaninov served as chief strategist and deputy head of research at URALSIB Capital.

He supervised the firm's equity strategy and valuation analysis techniques, leading a team of 30 professionals.

Kirill Chuyko, head of equity research at BCS Financial Group, commented: "[Smolyaninov] will be a key partner, especially when it comes to assessing market dynamics and consolidating sector analyses into an actionable investment strategy for the Russian market."

LCH.Clearnet has named **Steve Briscoe** as its new group head of technology and operations.

Briscoe will be responsible for the provision of IT and operations across the group's legal entities. He has financial services industry experience and joins from RBS, where he spent five years, most recently as head of operations for the markets division, with responsibility for the delivery of all aspects of operational service for investment banks.

Suneel Bakhshi, CEO of LCH.Clearnet Group, commented: "We are delighted to welcome Briscoe to the Group."

"[He] has a strong track record of delivery from his previous roles and will work closely with the senior management team to further develop LCH.Clearnet's technology and operations." **SLT**

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