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Northern Trust executives take leadership posts

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Two leaders of Northern Trust's Global Securities Lending group have been elected to senior positions within the industry.

Jeff Benner, deputy head of global securities lending, has been elected chairman of the EquiLend Holding LLC Board, while Richard Thompson, head of international securities lending product management, was elected chairman of the International Securities Lending Association (ISLA). Each will serve a two-year term.

"We are very proud of these appointments and the outstanding recognition of both Jeff and Richard by industry peers across the globe," said Andy Clayton, head of global securities lending for Northern Trust.

"Northern Trust is committed to promoting the advancement of connectivity and automation, as well being heavily involved with the industry's associations as a way to help shape the future of securities lending for the benefit of all market participants."

Brian Lamb, CEO of EquiLend, said: "I have worked with Jeff Benner for many years, initially as one of the many thought leaders that invented the EquiLend platform, and now I am very pleased to work closely with him again as chairman of the Board of EquiLend. The securities finance industry benefits when companies such as Northern Trust and EquiLend work together on market initiatives."

Both Benner and Thompson have served as vice chairs at their respective associations over the past year. At Northern Trust, Benner has responsibility for all securities lending activity in North America, including trading, relationship management, sales and product. Thompson, based in London, is responsible for international securities lending product management at Northern Trust. He has been in the securities lending industry for 13 years.

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NEWSINBRIEF

Japan tightens short selling rules

The Financial Services Agency of Japan has said it will prevent investors who short sell newly issued shares from buying the stock after the offer price has been set.

The move is designed to prevent excessive short selling on new issues. The new rule is similar to Regulation M in the US, which prohibits investors from taking short positions after the announcement of an offering and then buying shares in the offering.

The rules could be in place as early as April 2011, said the FSA.

Sucden Financial open to securities lending

Sucden Financial has announced that it will be launching a new service geared towards institutions to capture brokerage opportunities in the Delta One and Equity derivatives and finance arena with effect from January 2011.

This new desk will allow Sucden Financial to avail the major opportunities that not only exist across both Europe and the US, but also those presented by the emerging markets. All aspects of broking and client facilitation relating to Delta One, Equity Finance and Equity Structured Products trading will be encompassed in this new operation.

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SEHK adds new stock for short selling

The Stock Exchange of Hong Kong has announced that Glorious Property Holdings Limited will be added to the list of designated securities eligible for short selling, with effect from December 20, 2010.

A total of 640 securities are now eligible for short selling.

Northern Trust executives take leadership posts

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As a corporation, Northern Trust partners hold senior positions within all major securities lending associations around the globe, including the Risk Management Association (RMA), the Canadian Securities Lending Association (CASLA), and the Pan Asia Securities Lending Association (PASLA).

Thompson takes over from Blackrock's James Templeman. He was elected at the organisation's AGM, along with a new board of directors. The board now comprises of:

- Andrew Jamieson
- Anthony Duggan
- Brian Staunton
- Keith Haberlin
- Laura Allen
- Martina Szameitat
- Mohamed Moursy
- Richard Thompson
- Rob Coxon
- Tammy Phillips
- James Templeman
- Kevin McNulty

"ISLA continues to play an important role for all participants in the securities lending markets and noted ongoing work to help educate investors and market professionals, develop best practices and work with regulators to achieve sensible regulation of this $2 trillion market," said Thompson.

Sucden Financial open to securities lending

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To facilitate this business, Sucden has appointed Andy Wilkins, who joins the firm from BBVA Global Markets, where he established the Spanish bank's equity options business in London. Andy brings with him over 20 years trading and sales experience of the City. He began his career as an open outcry trader for Hull Trading on the LIFFE Floor, and with the closure of the floor, continued trading for the hedge fund UBS O'Connor, as a portfolio manager.

Announcing the new appointment, Michael Overlander, CEO, Sucden Financial said; "I am delighted by Andy's decision to join our team and excited by this new business opportunity for the firm. We aim to leverage Andy's extensive trading, sales, idea generation and price and liquidity discovery experience, to create a new Delta One and Equity Options business within Sucden Financial. This will act further enhance Sucden Financial's reputation as an efficient, expert and reliable trading partner."

SSGA to launch new Euro ETFs

State Street Global Advisors will launch a new range of ETFs across Europe in the first quarter of 2011.

The new funds will include equity and fixed income ETFs as well as a series of innovative funds. They will be listed in Switzerland and Italy.

SSgA head of intermediaries EMEA Vin Bhattacharjee said: "We physically replicate our funds. We have no intention of doing anything synthetic at the moment, although we might consider this in a year or so down the road.

We will come out with transparency on what percentage of revenue goes back into the funds.

"There's obviously quite a lot of focus on synthetic products and transparency, but securities lending requires this too and we'll be the leaders in this."

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SGGG Announces first hedge fund appliance

SGGG Portfolio Systems, has announced their first appliance built specifically for hedge fund managers. The appliance combines hardware, operating system, and SGGG's proprietary hedge fund software in a single pre-installed and pre-configured box. When connected to a hedge fund's network, the system provides real-time portfolio management and trade order management.

Hedge funds use the system for the entire trading and portfolio management process – to send trade orders to dealers, keep track of trades and portfolios and interface with their custodians. The appliance has pre-configured connections to numerous electronic trading systems and prime brokers. It combines the benefits of the SGGG online service with the improved response and interaction of a desktop application.

The appliance is proving very popular and SGGG has over 20 clients using it. Sophisticated features such as FIX messaging (a protocol for sending and receiving trade orders electronically) and automated position reconciliation usually require considerable network and software configuration. The appliance is designed to provide this functionality for any fund, even those without on-site IT personnel.

Dan Rissin, CEO of SGGG Portfolio Systems, said: "The appliance model enabled us to create a highly cost effective solution which can be targeted at funds that have traditionally been unable to afford or support high-end portfolio management software. The system does not require customisation because it has been designed to be easily configured for each client's needs."

Mark Tredgett, managing partner at hedge fund Vantage Asset Management commented on the implementation process: "The team at SGGG installed our portfolio management system quickly and efficiently, and ensured it was integrated with our prime brokerage and electronic trading systems. This was a critical step for our firm because the system has fully automated our business processes. As a result we can view every position in the portfolio in real time throughout the day."

The SGGG appliance can be ready to run in a couple of weeks, compared to the typical three to six month implementation period for similar systems. Ongoing support and upgrade costs are minimised through integrated remote support.

Wells Fargo sued over securities lending loss

Wells Fargo & Co is being sued by the School Employees Retirement System of Ohio over losses arising from a securities lending programme.

The fund says it lost $29.6 million because a unit of Wachovia Corp mismanaged a securities lending programme marketed as a "low-risk" way to boost returns.

It said $23.7 million of the loss stemmed from an investment by Wachovia Global Securities

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Lending of some of the fund's cash in notes issued by Sigma Finance Corp, a $53.5 billion asset-backed securities vehicle that failed in October 2008, less than three weeks before the notes matured.

"Sigma was not a suitable investment for SERS because of its inherent risks and lack of liquidity," the complaint says.

"Placing SERS' funds into a complex hybrid SIV with substantial leveraged interest rate risk is inconsistent with the objectives of safeguarding the principal," it added.

The fund said it lost 95 per cent of the $25 million that Wachovia had invested in Sigma. It accused Wachovia of breach of contract and fiduciary duty, negligent misrepresentation, and violations of federal and Ohio securities laws.

"All the investments were highly rated at the time of purchase," Wells Fargo spokesperson, Laura Fay, said. "We are confident that Wachovia acted appropriately and in accordance with our clients' best interests at all times."

J.P. Morgan commits to UK

J.P. Morgan has announced that its new European headquarters will be based in Canary Wharf, London.

The company already has a huge footprint in the UK, with offices in London and a processing centre in Bournemouth. It was rumoured earlier this year that the bank was considering its options in the UK, especially in the light of recent tax increases.

CECA to extend use of Algo Collateral

Algorithmics has announced that the Spanish Confederation of Savings Banks (CECA) has extended its use of Algorithmics' collateral management solution to support its members through a period of consolidation in the Spanish market prompted by the recent financial crisis.

CECA uses Algorithmics' collateral management product, Algo Collateral, to provide collateral management services to the Spanish Saving Banks through its Global Collateral Service Center.

Over the last six months, consolidation in the financial sector has reduced the number of Spanish savings banks from 45 to 34 much larger institutions within 17 financial groups. This has required CECA to adapt its systems and processes in a short period of time to meet the new collateral management requirements of its members.

Massimo Salerno, head of CECA Risk Services Center, said: "For us, it was important to work with a flexible, robust and scaleable collateral management solution. This enabled us to be responsive to our members at a very demanding time. Algo Collateral gave us the opportunity to provide both CECA and the Saving Banks with a solution that covers all the aspects of collateral management's operational workflow: exposure assessment, counterparty reconciliation, risk mitigation, settlements and accountancy."

Using Algo Collateral, CECA has adapted the service that it originally provided from the beginning of 2009, to accommodate new requirements for full asset class coverage, including derivatives, securities lending and bond repos. CECA's main objective was to provide market-leading collateral management services to support the new saving banks as market leaders in their field, to standardise processes and to support their customer business.

Leticia Canal, Algorithmics' sales director for the region, added: "We congratulate CECA on its ability to adapt the collateral management services it provides to its members using Algo Collateral. CECA was able to respond quickly to the changing market environment and to the impact of the consolidation within its membership."

Pakistan plans settlement automation

The Securities and Exchange Commission of Pakistan (SECP) has approved the project of 'Automation of Securities Settlement', at the Central Depository Company of Pakistan Limited (CDC), which was effective from December 20.

The project has been finalised in collaboration with the National Clearing Company of Pakistan Limited (NCCPL) and the three Stock Exchanges. The CDC will automate the mechanism for settlement of book-entry securities at the CDC through straight-through processing solution while eliminating the need for any manual intervention.

The mechanism will allow securities to be automatically transferred from the respective sellers' account to the respective buyers' account instead of being routed through the member's main account. The new system while establishing a link between the National Clearing and Settlement System and the Central Depository System will not only bring in more efficiency but also assist in preventing misuse of book entry securities to a large extent.

In order to ensure effective implementation of the project the amendments have already been approved by the SECP to the regulatory framework of the CDC and NCCPL along with necessary system developments and mock sessions for the market participants to provide them with hands-on training on the new system.

Eurex volumes down in 2010

The international derivatives markets of Eurex-Group ended 2010 with a turnover of approximately 2.64 billion contracts, compared with 2.65 billion in 2009.

The total volume for 2010 splits into 1.9 billion contracts traded at Eurex (2009: 1.7 billion) and 745.2 million contracts traded at the International Securities Exchange (ISE) (2009: 960.2 million). This corresponds to a daily average trading volume of 10.4 million contracts compared with 10.5 million in 2009.

At Eurex, equity index derivatives was the largest segment in 2010 with a total volume of 805.1 million contracts (2009: 797.5 million). Derivatives on the EURO STOXX 50® index were the largest single product with 372.2 million futures and 284.7 million options. The equity derivatives segment (options and single stock futures) saw 511.1 million contracts (2009: 421.3 million). In 2010, the interest rate derivatives segment

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reached a total of 574.8 million contracts (2009: 465.7 million). The segment dividend derivatives recorded the strongest growth of 78 per cent with 4.5 million contracts.

In December 2010, the Eurex Group derivatives markets reached an average daily volume of 8.3 million contracts with 5.8 million contracts traded at Eurex (Dec 2009: 6.15 million) and 2.5 million contracts traded at the ISE (Dec 2009: 2.7 million). A total of 177.8 million contracts were traded on both exchanges in December 2010 with 121.8 million (Dec 2009: 123.0 million) at Eurex and 56.0 million contracts (Dec 2009: 59.8 million) at ISE.

At Eurex Exchange, equity index derivatives recorded the highest turnover among all product segments in December 2010 with 56.1 million contracts (Dec 2009: 54.5 million). The top equity index derivative was the future on the EURO STOXX 50 index with 26.3 million contracts; another 18.3 million options on this index were also traded.

A total of 25.6 million contracts were traded in the equity derivatives segment, compared with 29.0 million in Dec 2009. Within this segment, equity options traded 20.1 million contracts and single stock futures another 5.5 million contracts.

A total of 39.6 million contracts were traded in the interest rate derivatives segment in December 2010, compared with 39.2 million in the same period last year.

Eurex Repo, which operates CHF repo, EUR repo and GC Pooling markets, continued to grow in 2010. The three Eurex Repo markets grew by 14 per cent and reached an average outstanding volume of 221.7 billion euros. Thereof, the secured money market GC Pooling hit a new record with an average outstanding volume of 91.6 billion euros, an increase of 25 per cent y-o-y; the EUR repo market totaled at the new peak of 114.5 billion euros and the CHF repo market achieved the new record of 107.2 billion euros.

In December 2010, all Eurex Repo markets grew by 39 per cent y-o-y, reaching an average outstanding volume of 274.1 billion euros. Thereof GC Pooling reached a new record figure of 110.9 billion euros (Dec 2009: 84.3 billion euros) and the EUR repo market reached a record outstanding volume of 133.8 billion euros, an increase of 35 per cent.

The electronic trading platform Eurex Bonds, which rounds out Eurex's fixed-income product range, traded 6.8 billion euros (single counting) in December 2010 compared to 5.2 billion euros in December 2009.

In 2010, Eurex Bonds traded a total volume of 101.6 billion euros (single counting), compared with 87.3 billion euros in 2009.

Kansas to focus on pensions

The State Government of Kansas has confirmed that the special committee to study pension issues formed last year will be made permanent.

Speaker and Hutchinson Republican Mike O'Neal said the state needs to address long-term funding woes affecting the pension system for state employees, teachers and local government workers. He says that's best handled by a standing committee, which has set meeting times each week the Legislature is in session.

There is currently a projected gap of approximately $7.7 billion between revenues and commitments.

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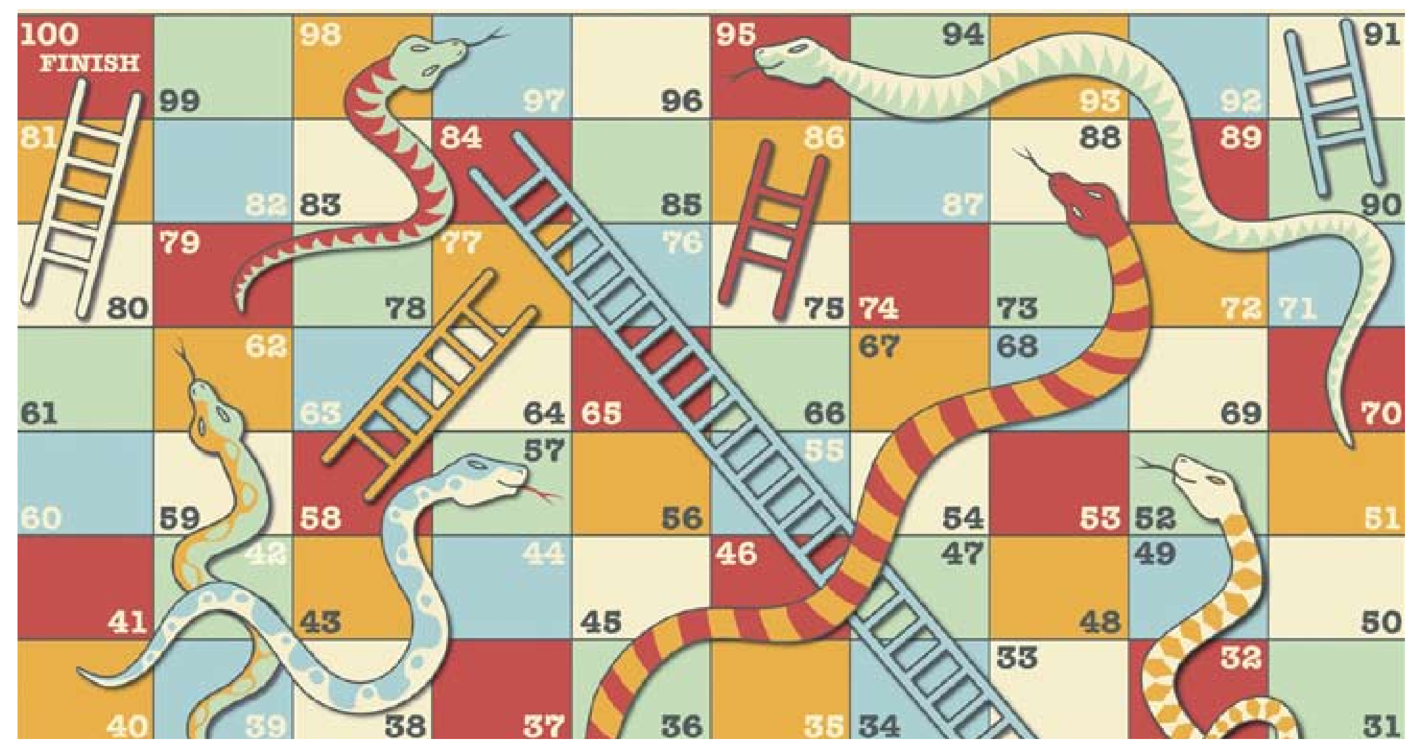

Luxembourg

At the heart of Europe, Luxembourg has long prided itself on being ahead of the game when it comes to financial services. And securities lending is no exception.

BEN WILKIE REPORTS

The Grand Duchy of Luxembourg is one of those countries that seasoned Euro travellers often miss out on - a tiny dot on the map, little is known about its history, its culture or its attractions. But in the financial world, Luxembourg is a colossus that has been punching above its weight for decades.

In part this is down to geography. Luxembourg is right in the heart of Europe, and it's easy to get to from most of the major financial centres elsewhere on the continent. But the country's success is mostly down to the commitment of its leaders to become the leading domicile for funds in the European time zone.

It faces competition of course. Dublin has been able to attract some serious players and is now a major jurisdiction in its own right. Gibraltar, Malta and the Channel Islands also play a large role in the European fund industry. But for decades Luxembourg has been pre-eminent, and considering the stability it showed throughout the recent turmoil, its position at the pinnacle is unlikely to change any time soon.

One of the key advantages of Luxembourg is its workforce. Having been a major funds centre for decades, the country boasts a highly qualified pool of staff, mainly from Belgium, France and Germany, as well as locals, who are fluent in the major languages and experienced in all aspects of the funds industry. Over 500 fund promoters are based in the country, and the technological infrastructure also means it is straightforward for businesses based there to sell across the continent.
But its regulation that's the key. Luxembourg was the first European jurisdiction to allow cross border distribution of funds. So a firm could base itself in the Duchy and sell across several countries from one hub. It's estimated that 80 per cent of European funds that are sold in three or more countries are domiciled in Luxembourg.

It's also been quick on the uptake when it comes to integrating trans-national regulations. As one of the first countries to be ready for UCITS I and UCITS II, Luxembourg was also one of the first countries to introduce UCITS III into national law in December 2002, a move welcomed by the local fund industry. In fact, the only barrier holding Luxembourg-based funds back is the speed at which other countries have been introducing the legislation - at present there are still restrictions in some jurisdictions on selling UCITS III funds. Since 2002, Luxembourg has become an in-

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creasingly important destination for hedge funds, an area that it didn't see much of prior to that time. An investment circular published by the Commission du Surveillance du Secteur Financier (CSSF) increased the appeal of the jurisdiction for hedge funds, and further moves - such as the abolition of subscription tax for triple A funds that are solely for institutional investors have increased the inflows of funds to the country. The new hedge fund laws didn't really change anything; they simply formalised the regulation for what had been generally understood in the markets for some years.

However, the fact that there are now formal laws has reassured a jittery market. The downturn of the past couple of years meant some offshore jurisdictions became wary of a flight to perceived quality - countries where the regulations were understood by regulators and governments who remained concerned that some areas of the financial industry were out of control. While Luxembourg of course experienced some ructions during the downturn, the impact was surprisingly low - due in significant part to the confidence both the industry and European governments had in the strength of the infrastructure of the country. And while there will always be complaints about the favourable tax status Luxembourg-based funds may receive, the mutterings about Luxembourg have been far more muted than in other jurisdictions, such as Dublin.

> Stephane Ries: Taxation hinders the creation of cross-border pension funds, Luxembourg acknowledged it could not attract many multinational pension funds and began to focus on getting the assets of those funds

The main issue affecting providers in Luxembourg has been simply keeping up with the volume of new regulations and laws coming through over the past couple of years as governments and regulators have panicked and tried to bring in barriers to further market turmoil. Whether it's on a cross-border level, such as the European Union Savings Directive or the impact of US laws such as Dodd-Frank, the new International Accounting Standards or local legislation, such as the recent German tax rules, the workload for some providers has become intolerable.

"As a small firm, we were spending more and more of our time and budget on preparing for new regulation," says one previous country manager at a boutique administration firm that has now been bought by a larger player. "There have always been issues with economies of scale, but because we offered a bespoke service we could still manage to give our customers the experience they needed. But with all the changes that have taken place in recent years we couldn't keep up and it's worked out for the best for both us and our clients that we are now part of a much larger organisation."

Consolidation has become the name of the game here. Many of the global players have made acquisitions, while several local names have merged. Further consolidation is expected.

The pension fund market has not been quite so successful. Although the law was changed more than a decade ago to allow pension funds to be launched in Luxembourg, so far only a handful have decided to do so. Taxation is thought to be the reason for this.

"Taxation hinders the creation of cross-border pension funds," says Stephane Ries, head of relationship management at the Investment Fund & Global Custody Department of Kredietbank S.A. Luxembourgeoise. "Luxembourg acknowledged it could not attract many multinational pension funds and began to focus on getting the assets of those funds into the domicile. Nowadays, if a multinational company is running several pension funds for the benefit of its employees, it can create a single investment fund in Luxembourg in order to leverage off economies of scale in pensions management. Luxembourg has just introduced an exemption from the taxe d'abonnement for these funds, which are also called pension-pooling vehicles."

One area where large amounts of growth is expected is in the servicing of alternative funds. SICARs and property funds are expected to become more popular, and the industry within Luxembourg is gearing up to service these different models.

Securities lending

Luxembourg is more of an administration centre than a jurisdiction where actual trading is carried out, and this is reflected in the limited amount of securities lending business that happens in the country.

But that's not to say it doesn't have an impact. "We're in Luxembourg not only for the administration services we offer, but because it is a vital hub for the information that we can provide our clients," says one back and middle office provider. "The data that we have is used by the Luxembourg-domiciled funds through their offices in this country for trades across Europe and the rest of the world. However, we carry out virtually no securities lending activity in the country itself. And I'm pretty sure no-one else does either." **SLT**

Alternative UCITS funds attracted €25 billion net new flows up to September 2010

According to a new study by Strategic Insight, commissioned by the Association of Luxembourg Funds Industry (Alfi) with the support of LuxembourgForFinance, alternative UCITS funds saw a 70 per cent growth in net new flows in 2010 to September, and are on track to finish 2010 with €33 billion net new inflows. This accounts for 15 per cent of total net inflows into all long-term UCITS funds.

Most of these funds represent hedge-style strategies adapted to the growing need for absolute return solutions. New alternative UCITS launched this year have already captured €6 billion.

The study, which considers the changing world for investors as alternative and traditional funds converge, demonstrates that:

Alternatives are a growing part of the UCITS regulated fund industry – products launched after 2007 are capturing nearly 70 per cent of net new flows to hedge type UCITS this year; from 2009 through the present, these newer funds have collected €35 billion of inflows overall.

A growing number of these alternative UCITS are run by hedge fund managers, although a substantial proportion are managed by retail oriented, traditionally long-only investment firms that are building their alternative ranges.

Significant changes in the hedge fund business, especially around regulation and the Alternative Investment Fund Managers" (AIFM) directive, are encouraging hedge fund managers to start UCITS funds.

Luxembourg domiciled products account for almost half (49 per cent) of total alternative UCITS assets and flows this year, and 45 per cent of the number of funds.

More hedge fund managers are now participating in the growth of alternative UCITS and catching up to mainstream managers. A greater emphasis on client care is helping in this process.

Commenting on the growth in the industry, Jag Alexeyev, head of global research at Strategic Insight, said: "Fund managers anticipate stronger commitments in 2011 as fund selectors and investors gain comfort with hedge style UCITS, and sustained expansion through the decade."

Camille Thommes, director general of Alfi, said, „The study has ambitious predictions for the growth of the alternative UCITS industry. Indeed, these predictions reflect the interest we are seeing from sophisticated investors for adequately regulated and supervised products, as well as hedge fund managers who were looking to start UCITS funds as a reaction to the uncertainties surrounding the draft AIFM Directive. "

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Managing funds ETFs and securities lending

Keshava Shastry, director at iShares Capital Markets, explains how the exchange traded fund industry can benefit securities lending

MARKET DEVELOPMENT

The global ETF industry

The global exchange traded fund (ETF) industry has seen phenomenal growth over the past few years. The first ETF was created, listed and traded in North America in 1993 and ETFs have since gathered significant assets in the US. At the end of Q3 2010, there were 890 ETFs listed in the US from 29 providers on two exchanges, with total assets under management standing at $797.2 billion.

In Europe, ETFs are 10 years old and there is evidence that the market is growing at a similar rate and in a similar fashion to what we have seen in the US. The European market is more fragmented given the variety of countries and financial jurisdiction spanned, and at the end of Q3 2010, there were 1,030 individual ETFs from 37 providers on 21 exchanges, with industry assets totalling $256.2 billion.

Investors in both regions, and indeed throughout the world, have used ETFs to gain access to markets in an efficient and precise way. ETFs track the performance of a given index, be that related to equity, fixed income or even commodity or real estate. They are simple to use and fees are commonly lower than those charged by active mutual funds. Since they trade on-exchange, ETFs can be also bought and sold throughout the day and pricing is updated continually, so investors can receive an accurate idea of the value of their holdings at any time.

ETFs and the capital markets

As the ETF market has developed, ETFs have begun to play an increasingly important role in today's capital markets. For example, several ETFs such as the iShares FTSE 100 fund are amongst the most traded instruments on the London Stock Exchange on any given day.

ETFs investors can benefit from the lending of underlying constituents of the ETFs and also lending of ETF units themselves. And more widely, securities lending in ETFs improves liquidity in the securities and derivatives markets, allows investors to express negative views on equities as well as positive ones and enables market-makers to provide an efficient two-way pricing mechanism to the market.

As ETFs in Europe have gradually moved into the mainstream investment universe, we have seen increased activity in ETF units lending activity in the region. However, the market has not yet reached the same scale and maturity as it has done in the US, which still represents the bulk of ETF lending activity, despite the efforts of lenders, brokers and other market participants to provide liquidity to the market to meet demand.

On-loan values in the top five European funds represent under two per cent of the funds' assets under management (AUM). In the US, the top five funds have on-loan values in excess of 15 per cent of assets under management, and borrowers are able to benefit from lower lending rates. This is a consequence of the fact that ETFs are a newer and younger product set here, but also indicates how the market could potentially expand.

Indeed, the market now appears to be gaining pace rapidly, with lenders seeing a considerable increase in demand over the last 12-18 months. Data Explorers, an independent aggregator and vendor of securities lending pricing and volume information, has observed that European ETF lending in the past year has increased by 149 per cent in dollar terms. In addition, the fact that on-loan values represent a high percentage of lendable values confirms that demand is strong and that there is an active lending market for ETF units, as shown in the table below.

ETFs and securities lending: how it works

There are two main aspects to the way in which securities lending benefits ETF investors. In the first instance, the ETF's investment manager can lend the constituent parts of an ETF and a portion of the revenue that this generates is returned to the fund. This activity, common in many unit trusts or mutual funds available to the public, accrues benefits to all fund shareholders as reflected in the fund's Net Asset Value (NAV).

Secondly, large shareholders can lend their iShares units, which is something that investors in other pooled fund vehicles cannot do. Each individual holder decides whether or not to lend their units, and any lending revenue accrues directly to that investor.

Higher lending fees in some European funds offer the ETF unit holder, otherwise known as the beneficial owner, opportunities for significant revenue generation, especially in funds which track illiquid or difficult to access markets.

From an operational perspective, the lending of the ETF units is a simple process. ETFs trade

Top 10 Funds with On-loan Values (May)

		USD/Millions						
Fund	Ticker	January	February	March	April	May	On-loan versus lendable	Average wholesale lending rate
iShares Euro STOXX 50	EUE	52	27	32	112	141	59%	1.40%
iShares EURO STOXX 50 (DE)	EUN2	22	22	27	128	140	90%	1.93%
iShares FTSE 100 Fund	ISF	148	90	27	35	102	66%	1.43%
iShares FTSE 250 Fund	MIDD	85	77	76	90	71	72%	2.70%
iShares MSCI Emerging Markets	IEEM	32	33	57	77	62	11%	2.39%
iShares DAX (DE)	DAXEX	59	33	36	45	60	123%	1.72%
iShares Stoxx 50	EUN	2	2	1	0.04	46	6%	2.09%
iShares MSCI World	IWRD	34	22	8	15	36	80%	2.06%
iShares S&P 500 Fund	IUSA	63	69	54	76	27	1%	1.58%
iShares MSCI Japan	IJPN	17	44	16	48	20	8%	1.87%
Total		**513**	**419**	**335**	**626**	**704**	–	–

Source: BlackRock and Data Explorers Limited – information available on www.dataexplorers.com.

and settle like equities. There are commonly four key participants in the process: the beneficial owner, the two intermediaries that facilitate the matching of supply and demand in the market place, and the borrower.

Contractually, the transaction usually consists of a temporary transfer of an ETF unit to a borrower, with the lender retaining full economic entitlement to the units, such as distribution payments.

ETFs and securities lending: what you need to know

Since 2008 we have seen an unprecedented financial crisis with the failure of several key institutions. As a result of these events, some investors have been cautious about or refrained from making their holdings available via a lending programme because of concerns around counterparty risk, and whether the other party is able to complete on the transaction.

It is vital that investors carry out due diligence before entering into a lending programme with any of their securities. There are always risks involved but the lending agent or custodian will be able to provide information on how such risks are actively managed and controlled. For example, borrowers may be selected on the basis of how well-capitalised they are. The transaction may be fully collateralised with only highly rated collateral accepted, revalued on a daily basis and taken at a value that is greater than the loan value. Collateral is also commonly held in a tri-party escrow or custodian account that is ring-fenced from the provider's balance sheet. There will be procedures and provisions for unexpected market conditions. In addition, the beneficial owner should ensure that they are aware of how the lending revenue is split between the owner and the agent.

In a bid to increase the supply of units and facilitate lending and borrowing, there are now matching services which put lenders and borrowers in contact with one another, enabling them to familiarise themselves and transact with counterparties active in the ETF space.

In liquid names, where the underlying securities are cheap to borrow, supply is being increased by lenders via "create-to-lend" transactions. This process involves the lender borrowing the constituents of the fund and using these to create ETF units for the sole purpose of lending them to the borrower. This type of transaction has enabled a number of investors to source inventory at competitive rates in a market where these units were otherwise unavailable. This is a result of borrow costs being based on the weighted average cost to borrow the fund constituents rather than the supply and demand of the ETF itself.

ETFs as collateral

Within the lending market, another area in which ETFs can play an active role is as a form of collateral.

Until recently, this subject is one that has provoked mixed opinion. There has been some lack of understanding of how ETFs are structured and how liquid they are. On the other hand, there is enthusiasm from some market participants who consider ETFs a better form of collateral than others.

Using single stocks, lenders often determine haircuts based on a fully weighted basket of an index. As index constituents have different weightings within the index, large amounts of collateral can be pledged from less liquid names within an index and this can potentially result in difficulty liquidating. Accepting an ETF with a physical structure however provides an underlying weighting equivalent to the index and assures larger weightings in the liquid securities.

Also in challenging market conditions, the nature of an ETF and the fact that in itself, it offers diversified exposure to a spread of stocks within an index, means that its volatility should be lower than a concentrated basket of securities.

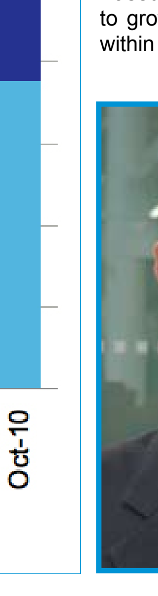
Finally, the open-ended structure of ETFs allows for the possibility to liquidate in the primary market, via an authorised participant, and in the secondary market should the need arise.

The future of securities lending and ETFs

The simplicity, flexibility and cost advantages of ETFs mean that they offer numerous possibilities and uses within the lending market. Priority has to be given to improving the supply in the market, which directly impacts the ability of investors to execute their trading strategies efficiently. Similarly, borrowing ETFs can be a competitive hedging solution relative to using futures or OTC derivatives. For all these reasons, there may be borrowing demand for many ETFs in various market conditions.

Current market data also demonstrates how the lending of ETF units is a growing component of the securities lending market. According to Data Explorers, there were over €12 billion in ETF units on-loan as at the end at end April 2010. Based on ETF growth, these figures are likely to grow as will the importance of this security within the lending space as a whole. **SLT**

300
250
200
150
100
50
0
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 Oct-10
ETF Equity Assets
ETF Fixed Income Assets
ETF Commodity Assets



Keshava Shastry
Director
iShares

View from the top

As we enter 2011, we asked our panel to comment on the issues of the past 12 months, as well as look forward to 2011. Thanks to our members of the panel who replied during the busy Christmas and holiday period.

Ben Wilke, editor

Rob Coxon
Head of international securities lending

BNY Mellon Asset Servicing offers clients worldwide a broad spectrum of specialised asset servicing capabilities, including custody and fund services, securities lending, performance and analytics, and execution services. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation. BNY Mellon is a global financial services company focused on helping clients manage and service their financial assets, operating in 34 countries and serving more than 100 markets. It has $22.4 trillion in assets under custody and administration, $1.1 trillion in assets under management, services $11.8 trillion in outstanding debt and processes global payments averaging $1.5 trillion per day.

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Missy Seidel
Securities Lending Global Product Head

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Brian P. Lamb
Chief executive officer

EquiLend is a leading provider of trading services for the securities finance industry. EquiLend facilitates straight-through processing by using a common standards-based protocol and infrastructure, which automates formerly manual trading processes. Used by borrowers and lenders throughout the world, the EquiLend platform allows for greater efficiency and enables firms to scale their business globally. Using EquiLend's complete end-to-end services, including pre- and post-trade, reduces the risk of potential errors. The platform eliminates the need to maintain costly point-to-point connections while allowing firms to drive down unit costs, allowing firms to expand business, move into different markets, increase trading volumes, all without additional spend. This makes the EquiLend platform a cost-efficient choice for all institutions, regardless of size.

Will Gow
Senior vice president, EMEA

With 10 years of experience, eSecLending is a full-service global securities lending agent providing customized securities lending solutions for sophisticated institutional investors worldwide. The company's approach has introduced investment management practices to the securities lending industry, offering beneficial owners an alternative to the custodial lending model. Their philosophy is focused on providing clients with complete program customization, optimal intrinsic returns, high touch client service and comprehensive risk management. Their differentiated process combines agency exclusives and traditional agency routes to market to achieve best execution while providing clients with greater transparency and control, allowing them to more effectively monitor and mitigate risks.

Sunil Daswani
International head of client relations

Northern Trust is a leading provider of asset management and asset servicing solutions for corporations and institutions worldwide.

Northern Trust began lending securities for its clients in 1981, and today offers 24-hour trading in close to 50 markets across four trading locations. Its aim is to optimise returns to clients' portfolios through customised lending programmes in the context of thoughtful risk management, and without impacting clients' investment strategies.

STATE STREET.

Nick Bonn
Executive vice president and global head of securities finance

State Street Corporation (NYSE: STT) is one of the world's leading providers of financial services to institutional investors, including investment servicing, investment management and investment research and trading. With $19 trillion in assets under custody and administration and $1.9 trillion in assets under management at March 31, 2010, State Street operates in 25 countries and more than 100 geographic markets worldwide.

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Craig Costigan
Executive vice president, general manager SunGard Securities Finance Software division

SunGard is the third largest provider of business application software, and customers all over the world rely on SunGard to fulfill their securities finance business needs. SunGard provides a comprehensive suite of securities finance solutions, from trade initiation through to final return; including order routing, trading, position management, operations, accounting, settlement, transaction analytics and benchmarking and trade automation services. With over 20 years experience SunGard has a global linked community of securities finance users. 17 out of the world's top 20 banks use one or more products from SunGard's suite of solutions for securities finance. SunGard's securities finance technology suite includes Apex, Astec Analytics, Global One, Loanet and Martini.

QUADRISERV

Bruce C. Turner
President & chief operating officer, Quadriserv, Inc

Quadriserv is a leader in delivering transformational market structure changes to the securities lending industry. Quadriserv, through its wholly owned subsidiary, Automated Equity Finance Markets, Inc, has developed the AQS® market for securities lending. AQS, through its relationship with The Options Clearing Corporation, has created a centralised market for securities lending transactions. As a FINRA member broker-dealer and a SEC regulated Alternative Trading System (ATS), AQS aims to maximise liquidity, access, credit and transparency, while mitigating systemic risk, through a fully automated trading environment.

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- Examining Intrinsic Value-Based Programs: What Advantages Do They Offer Today?
- Cash Vs. Non-Cash: A Risk-Reward Debate for Beneficial Owners
- Securities Lending Regulatory/Enforcement Update
- Point-Counterpoint: To Lend or Not to Lend? That is the Question, What is the Answer?
- An Industry Perspective on Central Counterparties: Are they the 'Good', the 'Bad' or Just 'Neutral' for the Advancement of the Securities Lending Industry?
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SLT: A popular topic throughout 2010 has been CCPs. What is your opinion of CCPs? What are the benefits, and what issues still need to be resolved?

Sunil Daswani: At this stage we are receptive to the idea of CCPs as their offerings with respect to securities lending evolve. CCPs have pros and cons to both the borrowers and lenders in a transaction. It is clear that CCPs have the potential to provide access to inventory on the demand side that they would not otherwise have. Additionally capital charges which will be an important feature in any financial organisation going forward will be reduced. On the supply side, the lender will need to understand what the additional costs or loss of flexibility would be involved in using a CCP. It also needs a full review of the credit risk and how this may change with the use of a CCP. Direct relationships with borrowers may be reduced or lost which is a key advantage in the absence of CCP's.

Lamb: The debate remains intact as to whether or not [CCPs] are needed by the securities finance marketplace.

Brian Lamb: In markets where CCPs are needed, I think they add much value. The benefits of these models are counterparty credit risk mitigation and price discovery and transparency. The debate remains intact as to whether or not these are needed by the securities finance marketplace. What exactly were the counterparty credit risk issues or problems that we need to solve? No one has yet articulated them. As far as price transparency goes, that is just an evolution in my opinion.

Nick Bonn: If there is a model that will provide liquidity in the marketplace and offer some form of risk mitigation, then we would be in favour of it. However, we haven't yet seen a model with these attributes. If the CCP is not directly accessible to a market participant then the model loses its primary draw and participation in the model could actually increase a concentration risk with the clearing counterparty. In this case, the value proposition also has to address the costs associated with participation from a lender's perspective, such as the additional fees associated with sponsored access and clearing. In addition, CCP models have to consider the drivers of supply and demand. If these forces are not aligned, it can be an obstacle to growing liquidity

Bruce Turner: The diversity of opinion is an essential component of any structural market reform, and that dynamic is certainly present in the securities lending market. At the end of the day, however, commercial and competitive interests are having the most profound impact, leading to clear momentum behind the adoption of a CCP (generally), and the AQS platform (specifically). With this in mind, we are seeing clear demand from all participants in the securities lending market for:

- Reduced risk, increased confidence: Central counterparties reduce bilateral lending risks, including counterparty default risk, and provide guaranteed mark-to-market payment, mandatory corporate action settlement, rebate rate payment and buy-in delivery for all transactions.
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- Transparency and price discovery: When borrowers and lenders view and transact on the same prices in an open market, accurate price settings emerge and the overall market quality improves.
- Efficiency and automation: AQS provides direct access to the securities lending market through seamless, all-electronic transaction and settlement processing, thereby creating and enhancing capital, operational and trading efficiencies.
- Post-transaction processing: AQS automates the daily actions of post-transaction processing. Integration between the electronic market and the clearance and settlement processes in AQS ensures the guarantee of payment and a reduction of settlement risk.

SLT: Are your clients asking you about securities lending CCPs? If so, what are they asking?

Lamb: Yes. All of my clients ask me about securities lending CCPs. In fact, most of them tell me that EquiLend already is the CCP in securities finance. They point out that we have unmatched global trading volume and liquidity. This is clearly an essential component to any successful CCP. We have a proven and well tested bilateral trading model as well as a model that is not bilateral. We have front to back integrated technology solutions. We are a registered broker dealer, an ATS and an MTF depending on the jurisdiction in which we operate. Perhaps they are correct.

Bonn: If the CCP is not directly accessible to a market participant then the model loses its primary draw

Daswani: To date we have had few queries from clients and little interest. Clients rely upon Northern Trust to perform credit checks against

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the counterparties we lend to. This process mitigates risk for clients. Of course clients always have the choice to customise or direct us in what they like to do but acting as an agent in the transaction it is our responsibility to ensure the transaction from end to end is robust and mitigated from risk where possible with the use or in the absence of a CCP. Clients are also being very precise about having highly tailored programmes right now which do not necessarily fit in a CCP model.

Bonn: No, the majority of our clients are more interested in the additional reporting, analysis and advisory services that we provide and in how they can use those services to analyse and manage the risks in their lending programmes on an ongoing basis. We are open to exploring any new models that come to market, however, like the existing CCPs on the clearing side, any new entrants would need to develop a plan for attracting liquidity and somehow offset the costs associated with participation.

Turner: We are seeing interest from all participants in the securities lending value chain. The growth of AQS speaks volumes in this respect: we have 48 member institutions and process active order flow in 94 per cent of the S&P 500, 70 per cent of the Russell 2000 and the vast majority of all ETF fund families. In addition, we see in excess of $8 billion of orders placed in the market each day. Our clients are also increasingly interested in the real-time market data that can only be generated from a true marketplace such as AQS.

SLT: 2010 has been a relatively flat year on most fronts, what are your predictions for 2011?

Lamb: I disagree. 2010 was anything but a flat year at EquiLend and the overall securities finance market continued to see significant change. I believe this will continue into 2011. In fact, I believe 2011 will see more change than we've seen in quite a while. We are likely to see some players drop out of this market, some continued consolidation as well as greater regulatory clarity. It will likely continue to be a tough environment but still a very exciting one. Watch this space!

Daswani: We believe supply will continue to rise, utilisation of portfolios and demand will continue to be stable to increasing slightly.

Bonn: Coming out of the financial crisis, clients are understandably risk averse and the securities lending industry continues to evaluate what has worked effectively and what needs to be fine-tuned. This work will probably continue through 2011 and those most willing to look through a new lens will certainly make the best progress. For the industry to emerge stronger from the global financial crisis, it is clear that more transparency, education and programme oversight are needed. For example, while some lending agents have always made transparency and access to daily reporting platforms a cornerstone of their service offering, vast differences exist regarding the type and quality of information available. What is not in question is that securities lending continues to play a vital role in the growth of capital markets, and asset owners enjoy the benefits of well-run, fully transparent programmes. Ultimately, those providers with the global resources, scale and best risk management practices will lead the industry's future success — regardless of market conditions.

Turner: Let's start with the data: Brad Hintz, senior analyst with Bernstein Research, has predicted 18 per cent growth for the industry in 2011. While we do not specifically endorse that prediction, we do believe that two key themes underlie the market in the year ahead. The first is an acknowledgement that, as the industry resumes growth, a centralised securities lending market should be a complementary tool designed to work alongside existing business practices and grow the industry as a whole. The second is that regulatory issues, the importance of capital efficiency, growing technology needs and changes in trading dynamics have all converged at a time when all market participants stand to benefit from a new, centralised model.

Missy Seidel: Many forces will influence supply and demand in 2011, most notably the regulatory environment. Regulators across jurisdictions have been drafting rules designed to promote transparency and control, but it is still too early to assess the impact of the changes. In the US, Dodd Frank is subject to additional rule making over the next two years and the effect of Basel III and AIFMD in Europe won't be known until sometime after the changes take effect in 2013. While we seem close to resolution on the EU short selling proposal, there is still ambiguity as to how the rules will ultimately impact lending. This broad uncertainty has produced a lack of conviction on the borrowing side, and ultimately subdued demand in 2010.

Seidel: In the US, Dodd Frank is subject to additional rule making over the next two years and the effect of Basel III and AIFMD in Europe won't be known until sometime after the changes take effect in 2013. While we seem close to resolution on the EU short selling proposal, there is still ambiguity as to how the rules will ultimately impact lending.

I think the industry is cautiously optimistic that demand will return once the regulatory environment stabilises and the economy continues to improve. We have already seen some positive signs in the form of a rebound in hedge fund assets and an increase in M&A activity. We also anticipate that more hedge funds will implement active trading strategies, which should translate to an uptick in demand.

On the supply side, many beneficial owners have been through a review of their programme and providers, and are engaging with more knowledge than ever before. Flexibility and transparency remain front and centre as beneficial owners now correctly demand specific collateral and programme parameters. The ability for a lending provider to be flexible and provide a customised programme is critical, and the most nimble providers will be well positioned to gain market share. The trend will continue for more beneficial owners to select lending agents based on their merits and expertise, rather than on custodial or other relationships. As a specialist provider whose programme was founded on value lending and a flexible platform, BBH saw a record growth year in 2010 and we expect 2011 to be no different. **SLT**

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The right advice

Adrian Morris, head of consulting at MX Consulting, explains how his firm is helping clients reduce their costs and increase their revenues

Exclusive

SLT: What does MX Consulting do?

Adrian Morris: We are a business that specialise in securities financing and other structured products. We work on both business and IT related projects. More often than not the two go hand in hand; our principal object is delivering well managed change into client organisations. One of the advantages that we give our clients is that we have all come from the securities financing industry, either from the business or IT side. Our consultants tend to have in excess of a decade or more experience in the industry.

SLT: How is this of advantage to your clients?

Morris: Well I think one of the biggest problems clients have is creating teams of people for specific pieces of work who understand what is required by the business and what to do during the life-cycle of any project to successfully deliver it to a conclusion. We are able to bring in either specific expertise or a team of people who have the required skill sets and who have most importantly been working with each other for a long time.

SLT: Why is this important?

Morris: It is very difficult to go out and either source individually or create a team of people who often do not know each other or each other's capabilities and in a very short period of time gel that team together to deliver often large and complex pieces of work that may have considerable revenue drivers or cost implications if badly run. We offer a specialised service from programme and project managers to business analysts and developers, some with very particular skill sets within securities lending such as Swift messaging expertise. Most importantly we all have a good understanding of the client's business as well as how to get things done in the business and IT world.

SLT: Is this more efficient from a cost perspective?

Morris: We are commercial in terms of our rates. We have a reputation with our clients of delivery to schedule and this means we are often reducing overall expenditure on delivery versus projects that overrun and overspend.

SLT: What type of work have you been involved with in recent years?

Morris: All types and quite varied. We became responsible for the delivery of the 4Sight system into Aviva Investors replacing Global One in 2008/2009. This was a very complex project as some of the proprietary systems such as fee billing and income processing were reverse engineered into 4Sight. We have a great deal of Global One knowledge and to that end we have built fee, income, messaging, collateral management, cash payment and other proprietary systems that are fed by Global One over the years to enhance clients straight-through processing capabilities and reduce operational risk. We are used to working with the front office directly with traders through to the back office operational areas and understand how the two interact. Understanding the realities of this business environment is to key to delivering change successfully.

SLT: And currently?

Morris: As an example we are currently running a large programme for an investment banking client that will enable it to automatically move available equity and fixed income positions between their agent lending, principal and repo desks via normal stock loans and repos which will have a high and positive impact on revenues. This is a very large piece of work involving almost every system in each business and has required us to solve complex issues with the front and back offices of each business. We will also be working on a project that upgrades Martini to Apex in the next few months as well as compliance and messaging project work for another agent lender client.

SLT: Is your work often revenue associated?

Morris: Mostly, yes. We are more often than not involved in projects that either enhances revenue by increasing desks' ability to trade or optimising flows which enhances profits by cutting overheads. It is also important to remember that traders cannot increase their volumes without increasing their STP rates in the back office so we very much take a front to back approach.

SLT: What do you think you will be focusing on in the next year or so?

Morris: We are one of the few consultancies that have managed migrations from Sungard's Global One to other vendor systems; certainly we are aware of businesses more generally reviewing their trading and operational systems. Many have tangled system legacy issues that need reviewing and we think our experience makes us particularly relevant in this area. Projects of this nature are complex, require lots of experience and if badly run can become extremely expensive.

We also know a lot of businesses are now looking very carefully at processes that have in the past been very manual or spreadsheet orientated with a view to reducing risk. They are looking at better ways to optimise their business, collateral management being a particular issue since the demise of Lehmans. We built a cash and collateral management system for Paloma Securities (Now Bank of Montreal) that has been very successful and we think this type of experience and our approach to delivery is what clients want.

SLT: How do you deal with clients, what is your approach?

Morris: We usually recommend starting any engagement by having one or two senior consultants spend a few days with the client to get an understanding of the work. We like to do workshops with lots of people involved, understanding the strategic drivers and the clients' requirement is clearly the correct starting point. We take the information away and then create a short summary of what we think the client needs to consider, what the structure of a project should be, how we see the deliverable and the associated timelines and cost. This is a good approach, we like to keep everything very open and engage with the business, IT and other interested parties like compliance and risk and it is always, after all, a joint effort.

SLT: What are the aims of the business in 2011?

Morris: We want to become more recognised in the securities financing industry. We have been very successful at delivering projects for our current clients though maybe not so good at making this more generally known. We feel the industry needs specialised and focused securities financing experience to manage change and that too often failure happens as either the wrong people are engaged on projects or there is not enough experience to structure and manage work to properly engage the sponsors and involved parties properly.

Businesses need people who can deal at all levels of the organisation and are not afraid of making it clear when things are not right. We are in the business of delivering change, clients need clarity to make the correct decisions and they should always be in the driving seat making those key decisions throughout the life of any programme of work. **SLT**

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Changing the game

Securities Lending Times speaks to David Little in his new role at Calypso Technology

Exclusive

In August we reported that after 10 years David Little was leaving Rule Financial to pursue fresh challenges. Here we catch up with Little after he has had time to get his feet firmly under the table in his new role at Calypso Technology, a global financial software and services company.

Calypso Technology serves a broad spectrum of customers including sell-side financial institutions such as bank and prime brokers, buy-side firms such as asset managers, hedge funds, insurers and corporates, as well as treasury providers including exchanges, clearers and service consortiums.

SLT: Could you tell us where you fit in and what your new role is?

David Little: I am responsible for developing Calypso's business as a securities finance and collateral management product. So my role is one of strategy and business development - working with clients and prospects to understand the market and its needs and drivers and working with the product development teams to develop the product to serve those needs.

SLT: Calypso is not known for securities finance technology. Does this mean the company has a mountain to climb?

Little: Yes and no. We've certainly got some work to do, but we are starting from a very interesting position that gives us some significant advantages. Calypso was designed from the outset to be a cross asset front to back system including risk and finance. As such it has an extremely good data model that gives a true business representation whether you are looking from an equity stock borrow loan perspective or a fixed income repo perspective or indeed, coming from a synthetic financing direction. This is the foundation upon which everything else rests and with Calypso we are building upon a very strong foundation. Calypso already has very good back office repo and stock lending functionality. So while we certainly have some work to do, we don't see it as a huge mountain to climb. It's certainly an investment and one that Calypso is committed to. We see finance and collateral management taking a more and more important role in integrated trading strategies where perhaps in the past it has been more of a specialised and separate activity.

SLT: How do you see your 10 years at Rule Financial aiding you?

Little: At Rule Financial I learned a lot about partnerships and cooperation and how best to support business users. There are typically three parties involved: the client's IT group, the professional services firm and the vendor. Each party has its role to play with strengths and insights and when they work well together they can provide the business with a very high standard of service and an ability to act rapidly and cost effectively.

I have worked for clients and consultancies and now for the first time I am getting the vendor perspective and bringing an appreciation of all three to the role. I can understand the business being frustrated with technology. Technology is simultaneously the great enabler and the Achilles heel for users. I hope to be able to take the diverse experiences I have gained and channel them to provide practical and effective solutions that can be delivered in partnership with all the other groups that are involved.

SLT:How has Calypso fared over the past few years?

Little: Calypso's corporate profile is slightly different to other vendors in the space. Calypso is a medium-to-large sized company with over 500 employees and a single product (which is also called Calypso). We have grown consistently every year and now have a strong balance sheet with no external debt or shareholders. We are a truly international firm with offices in 13 cities covering all the major markets. That gives us a very strong focus with no distractions and an ability to invest significantly in chosen areas. As a cross asset system Calypso finds itself in many different business areas - cash and treasury products, OTC derivatives, securities, commodities and so on.

I think if you look at the evolution of products in the capital markets industry there was a strong trend where products have become ever narrower and more specialised in order to win. One of the side effects of that trend was a huge number of deployed systems with multiple versions of the truth and a need to reconcile those multiple versions at a high support cost. But that was a price that the business was prepared to pay in order to have best of breed solutions. We're perhaps now seeing a counter trend starting with systems that have a broader scope but are every bit as capable functionally as the specialists. Calypso is perhaps the most modern of this new breed of system. I don't see silos or specialisation ending any time soon, but I do think that there is a demand for rationalisation and for systems that can present a cross asset view with rich functionality and a single version of the truth.

SLT: Does Calypso have an opinion on the growing interest in CCPs?

Little: Nobody knows to what extent CCPs will develop in the securities finance markets, but it's certainly clear that there's no rush to adoption at the moment. In stark contrast, the introduction of CCPs in the OTC derivatives and swaps markets as a result of Dodd-Frank is a significant development for the industry and adoption is underway at breakneck pace with firms competing to dominate.

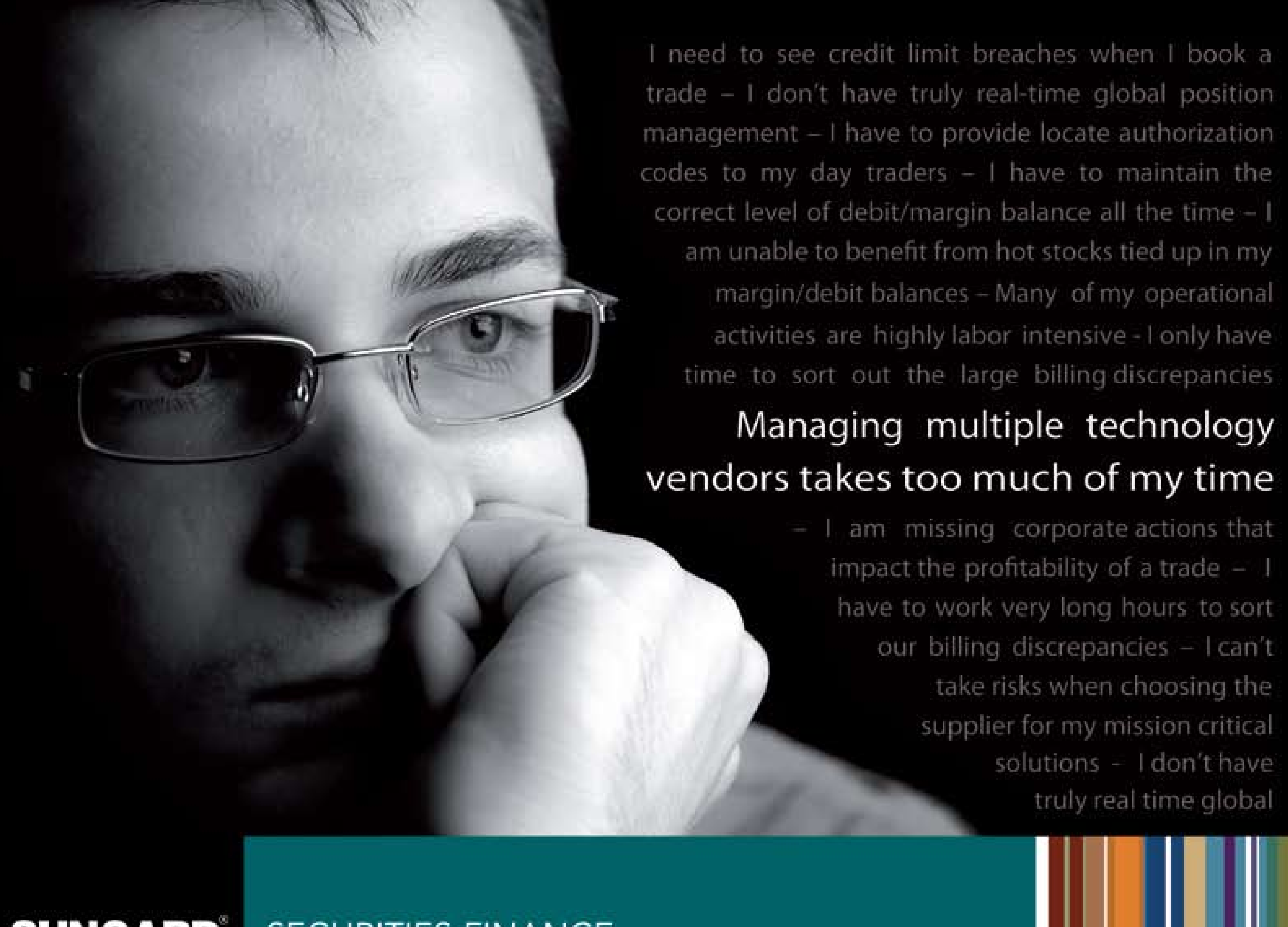
At Calypso we have played an important role in that process. Although Calypso was designed as a trading and risk system and was not envisaged as a central counterparty system, we found that because of the flexibility and configurability of Calypso we were able to rapidly reconfigure and deploy Calypso as the CCP engine in many central counterparties around the world. We have built upon that by providing systems for Direct Clearing Members (DCMs) and for participants who connect via DCMs. So Calypso has probably got a greater market share of the new CCP business than any other product. We have learned a great deal through that experience and one of the most complex and interesting areas is collateral management. The swaps market is huge in comparison to the securities finance markets – of the order of 100 times larger in value of outstanding trades. Not all of it will end up on CCPs, but a growing proportion will and it will have a significant impact in collateral management, providing huge opportunities for those who are best positioned to exploit them.

So even if CCPs do not encroach directly into the Securities Finance space, I think the indirect effect from changes in the way collateral is managed for OTC derivatives and swaps will have a big impact. And because we don't know what the future direction is going to be, it makes sense to have flexible and capable systems that can react responsively to change.

SLT: Is regulation a good thing from your viewpoint?

Little: Regulation is certainly becoming a stronger driver of change throughout the markets and so to that extent it drives demand for all suppliers. But the real challenge is to trade smarter. At its best, regulation and risk management work towards creating a level and safe playing field providing the best environment for orderly trading and efficient markets. Of course, that's not an easy thing to achieve in practice, with unintended consequences and inconsistency of regulation being constant thorns. But few would argue that strong systems with accurate, timely data and the ability to feed reliable information to all interested parties is the key to squaring the circle for all participants.

Detailed oversight, whether internal or external, is here to stay. It is no longer an option to work with inadequate systems and tactical fixes. We need strong systems that can adapt quickly when change is required whether to exploit a new opportunity or to comply with a new regulation. Calypso is such a system, fit for purpose. **SLT**



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The big interview

Securities Lending Times speaks to OneChicago's Abel Aronovitz about the innovations the exchange are bringing to the market

BEN WILKIE REPORTS

SLT: I have heard a lot of market chatter about your new products. What is OCX.NoDiv?

Aronovitz: OCX.NoDiv is the latest product launched at OneChicago. The traditional SSF priced in the EXPECTED dividend amount whereas the OCX.NoDiv adjusts the settlement price by the ACTUAL dividend amount. When expectations and reality diverged market participants were exposed to risk and opportunity. Some did not want to have this risk exposure. With the OCX.NoDiv contract the single stock future value is not impacted by dividend variations like our traditional contract. This levels the playing field and addresses the informational disadvantage vis-à-vis dividend streams for market participants. As a result, the new OCX.NoDiv product removes the dividend risk from the pricing.

SLT: Why did you decide to launch the new products?

Aronovitz: Dividend risk and tax implications were two major factors holding some securities lending participants from becoming involved in the U.S. EFP (Exchange of Future for Physical) market. The new OCX.NoDiv product assures the market participants that the future will have the same economic characteristics as the underlying and the exact equivalent dividend payment will be realised. The result is that the holder of the SSF via an EFP will have an identical return profile to holding the underlying instrument.

From at tax perspective the OCX.NoDiv product clearly has an equivalent dividend payment when the settlement price is adjusted. Previously we were told that our traditional SSF did not have an exact dividend payment as it was subject to change. With the OCX.NoDiv contracts, a long SSF holder is credited with the actual dividend amount and a short SSF holder is debited by the actual dividend value. Therefore an EFP using the OCX.NoDiv SSF should be interpreted as meeting the definition under section 1058(b). Whether it is a GC or hard-to-borrow security, an EFP is an economically equivalent lending/borrowing process.

SLT: This sounds similar to an equity repo product?

Aronovitz: Yes, that is the intent. Securities lending, swaps and repo transactions are financing transactions. The EFP using the OCX.NoDiv contract is simply an equity swap focused on the forward interest rate. By swapping a stock for the OCX.NoDiv contract, this has now become a centrally cleared, exchange traded, transparent, and regulated fixed-term equity repo market. An OCX.NoDiv EFP is a delta neutral product with no dividend risk; therefore market participants are solely focused on their financing rate.

SLT: How is the price of the future adjusted for the dividend amount?

Aronovitz: Whenever a dividend event occurs the price of the OCX.NoDiv contract is adjusted by the dividend amount prior to the open on the morning the instrument trades ex-dividend. The long SSF holder is credit adjusted by the dividend amount. The short SSF holder has the value debit adjusted from their account. Because the dividend value is credited on ex date, long holders are receiving the dividend value earlier than the pay date of traditional long stockholders.

SLT: What is the liquidity like in the OCX.NoDiv products?

Aronovitz: Derivatives 101 states that liquidity is as deep as the underlying cash market; otherwise an arbitrage situation would exist. The participants in the EFP markets at OneChicago are sophisticated, professional traders consisting of market making organisations, hedge funds, proprietary trading groups, and bank trading desks. They have the size, scale, and scope to enter any market that provides the optimal financing rate. This has created an active market for participants to enter, exit, and roll positions.

SLT: Who are the participants most active in your markets?

Aronovitz: Because a SSF EFP trade is a Delta One product, market participants in the cash, options, and swaps markets are now looking at using the futures market as an overlay programme to their equity finance activity. The EFP is serving as an alternative for securities lending/borrowing, swaps, combination and conversion trades, cash management, and synthetic equity exposure. Our products have the ability to bring all of the participants into one central market place. As a result, securities lending teams, long/short equity funds, index strategies, delta-one finance desks, proprietary trading firms, leveraged mutual fund strategies, etc… anyone looking for more efficient ways to finance equity positions, should be looking at the OneChicago markets.

SLT: You mention efficiency quite a bit. In your opinion, why is the EFP a more efficient securities lending tool?

Aronovitz: The reduction in middleman fees and pricing transparency alone would answer the question but EFPs are more efficient because they optimise cash flows and reduce portfolio risks. From a cash flow perspective, both lenders and borrowers are freeing up capital and are funding their equity exposure at market-determined rates without changing their delta position.

Portfolio managers also have the ability to reduce tracking error versus benchmarks as the actual dividend value is credited at ex date rather than pay date with stock. Therefore fund managers are receiving the divided equivalent value well in advance. This solves cash equitisation issues and reinvestment slippage as well.

Furthermore, the EFP provides the ability for more participants to be involved in the equity finance business that were historically passing off equity finance revenue to other participants. All fund managers now have the ability to capture equity finance returns in their equity execution process.

From a risk perspective, fewer intermediaries are involved in the financing process resulting in less operational risks and less fees, allowing more of the revenue to flow to the true lenders and borrowers. Also, because all contracts clear through the AAA-rated, Options Clearing Corp, counterparty risk has been mitigated.

SLT: Single Stock Futures have been around for a while. Why should beneficial owners embrace the products now as an equity finance product?

Aronovitz: As many beneficial owners have learned the hard way, loaning a stock to invest collateral and receiving a forward agreement to recapture the stock is an OTC transaction that inherently adds counterparty and reinvestment risks.

The irony is that a small retail customer that utilises an EFP trade is able to capture securities lending profits without the risks, but large funds with their vast resources are passing up this lending revenue

Selling a stock and entering into a futures contract removes the counterparty risk, removes the reinvestment issue, provides a better total rate of return and is executed on an exchange in a transparent, regulated, centrally cleared environment.

Traditional processes utilising agents and other middlemen were acceptable because of the perceived complexity of the transaction and the counterparty exposure in the OTC market. Today's realities are that the funds with just a little bit of effort can directly control the lending process and execute economically equivalent transactions that provide increased yields; all while eliminating the risks.

The irony is that a small retail customer that utilises an EFP trade is able to capture securities lending profits without the risks, but large funds with their vast resources are passing up this lending revenue. This shouldn't be the case. In a low return environment, fund managers should be generating this extra alpha by focusing on their costs and the efficiency of their equity finance process, while reducing their risks.

SLT: Do you plan to continue to expand your product offering?

Aronovitz: OneChicago now lists approximately 1600 securities including 200 ETF and 200 OCX.NoDiv contracts. The new '1D' OCX.NoDiv contracts will trade side-by-side with the existing '1C' futures. Because of the strong feedback about the products, we are looking to add approximately 50 OCX.NoDiv contracts per week going forward.

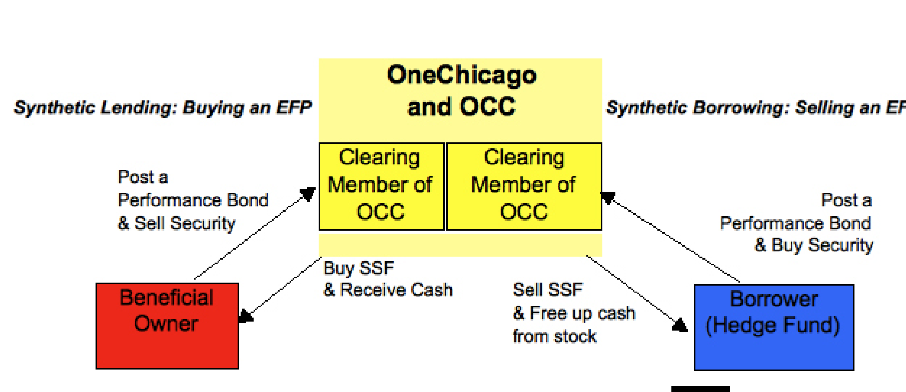
Currently most of our contracts go out under a year. However we foresee possibly listing contracts that go out further in time though, now that there is no dividend risk. Fund managers would be able to lock-in positions for extended periods of time and be able to hedge their interest rate risk based on changes in the yield curve. That could be an interesting development that some clients have expressed interest about.

SLT: How has participation evolved at OneChicago?

Aronovitz: Despite challenging market conditions, volumes continue to grow steadily at OneChicago. Through the month of November, volumes are up 64 per cent YoY with most of the volume being block and EFP transactions.

Besides the volumes though, our participants profile has significantly changed over the past few years. Our current largest clients weren't even trading in our markets at the beginning of 2010. Additionally when we look at our pipeline, we believe that our largest participants six-months from now aren't currently trading SSF.

OneChicago has evolved from retail traders and small hedge funds taking direct market views into an institutional equity finance exchange. There are approximately 25 institutions that have an OCX.BETS terminal (Block & EFP Trading System) enabling them to have point-n-click execution capabilities. More and more of the larger brokerage firms are now clearing our products. The changing regulation of OTC products and focus on market efficiency is driving client participation to our markets. **SLT**



Abel Aronovitz
Director, institutional sales
OneChicago

2010's IPOs grab headlines

Will Duff Gordon takes a look at the fortunes of the major new listings

Exclusive

There have been plenty of headline grabbing IPOs in 2010 with many companies seeing their shares drift lower post flotation - but before we jump on the bandwagon I took a quick look at Sports Direct (SPD), which was the "overvalued" IPO of its time in early 2007. Merrill Lynch came in for some stick at the time when it fell 60 per cent in its first eight months of trading. Short sellers made hay but interestingly the shares have been continually climbing since the credit crunch and are up 55 per cent this year. Does it take time for companies and investors to get to know one another, and therefore foolish to judge an IPO after only a few months?

The above chain of thought will not have much truck with retail investors who bought shares in online betting exchange Betfair (LON:BET) on the float at GBP 15, given they are now trading at just over GBP 10 per share. Some short selling is occurring to the tune of 1.3 per cent of all shares which is 22 per cent of supply. This rose recently but is not that significant. Of more interest is the fact that funds who lend bought 3.1m shares in Betfair at the float but have been selling their shares and now only own 2.76m shares or 2.6 per cent of the company.

UK grocery delivery firm Ocado (LON:OCDO) has been popular to short, with up to 11.25 per cent of all shares on loan due to the WM Morrison Daily Mail bid rumour. This led to some short covering with the latest figure being 10.5 per cent. However, unlike in Beftair, our proxy for the view being expressed by the long term investors is positive since they keep adding to their stake in Ocado and now own 47.4m shares which is nine per cent of the company.

Trendy clothing firm, Supergroup (LON:SGP) is a marmite stock in the sense that the short interest kept rising since June (the IPO was in March) while funds who lend kept buying shares, showing confidence. The latter investors have been generally right since SGP floated at £6 and reached £16. Short sellers finally saw some signs their patience could be rewarded when the shares fell badly on this week's earnings.

In the US, this year's IPO market has been more than interesting, especially in regards to Chinese companies floating there. We covered the corporate shenanigans surrounding DuoYuan in late September and can see that short selling remains high despite the shares having bottomed out at $3 after falling from $8 in September. Mecox Lane (NASDAQ:MCOX) is another one suffering from post IPO blues falling from $16 to $7, with stock on loan rising in late November and staying quite high relative to the shares that are borrowable at just under 0.6 per cent of total shares. There is a court case in process regarding MCOX.

Youku.com (NYSE:YOKU) means "What's best and what's cool." Sadly, short sellers don't think this applies to their online video content and have instantly borrowed as many shares as they can on the recent IPO!

There seem to be two types of IPO at present – mining/resources versus every other type of company. Investor scepticism surrounds the latter while investors are far more keen on the former. **SLT**

Will Duff Gordon
Media director
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Industry Appointments

The Options Clearing Corporation has announced the promotions of two officers.

Mary Savoie will become first vice president, industry services. She is currently vice president, industry services. She will continue as lead manager of the Options Industry Council, an industry cooperative programme of comprehensive options education for retail and institutional investors and financial advisors. Savoie will also manage OCC's role in organising the Options Industry Conference and OCC's Corporate Communications function.

William Eineke has been promoted to vice president, risk management from director, risk Management. In this role he will be responsible for increasing OCC's risk management systems role by expanding the products covered by OCC's risk-based haircuts and customer portfolio margin data and more importantly will lead the multi-year systems effort to convert OCC's pricing systems to the new technology.

These promotions come at the end of the eighth consecutive year of record volume cleared at OCC.

Bjarne Graven Larsen, chief investment officer at Denmark's largest pension fund ATP, is moving to take up the role of co-chief executive a FIH Erhvervsbank.

The bank was recently acquired by ATP and another large Danish pension fund, PFA, as well as Swedish pension insurance provider Folksam.

Replacing Larsen, at least temporarily, will be **Henrik Gade Jepsen**, currently deputy chief investment officer. A replacement will eventually be appointed by the fund's board.

Global head of prime services at Nomura **Tim Wannenmacher** has left his role at Nomura.

Wannenmacher, who took up the position in 2009, when Nomura bought the European operations of Lehman Brothers. Based in Hong Kong, he shared the role with London-based Gunner Burkhart.

Chris Antonelli, currently head of prime services in Japan, is expected to replace Wannenmacher.

Thomas Treadwell has been hired by Citigroup to expand its prime finance derivatives clearing business in the Asia Pacific region.

Treadwell joins from Barclays, where he was head of prime services in Singapore. He moves to Hong Kong to become business manager for derivatives clearing at Citi.

Citi has also hired Martin Visairis as head of capital introductions in the region. He joins from Bank of America Merrill Lynch

Rob Scott, co-head of global sales and relationship management at Deutsche Bank, has left the firm Deutsche Bank.

Scott has been placed on gardening leave following his resignation. He was appointed to the role in July 2010, working alongside Michael Aschsuer, where the bank planned to expand its focus on client needs within the custody space. Scott joined Deutsche in 2007 as managing director and global head of securities clearing and financing. No replacement has yet been announced.

Peter Astleford, co-chair of the Dechert LLP's global financial services group and head of the practice in Europe, has been appointed as the only private practice lawyer to the Investment Management Consultative Working Group.

The committee, appointed by CESR (Committee of European Securities Regulators) meets four times a year in Paris or Rome as the industry committee responsible for advising CESR/ESMA on all their work in the field of Investment Management for Europe.

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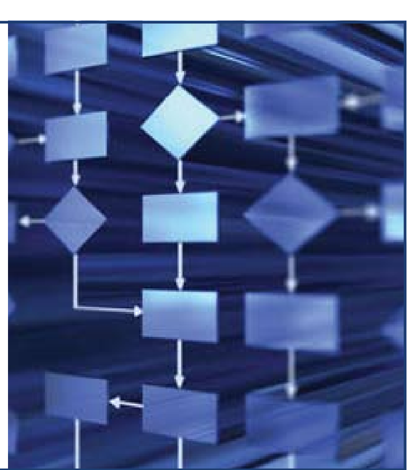

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