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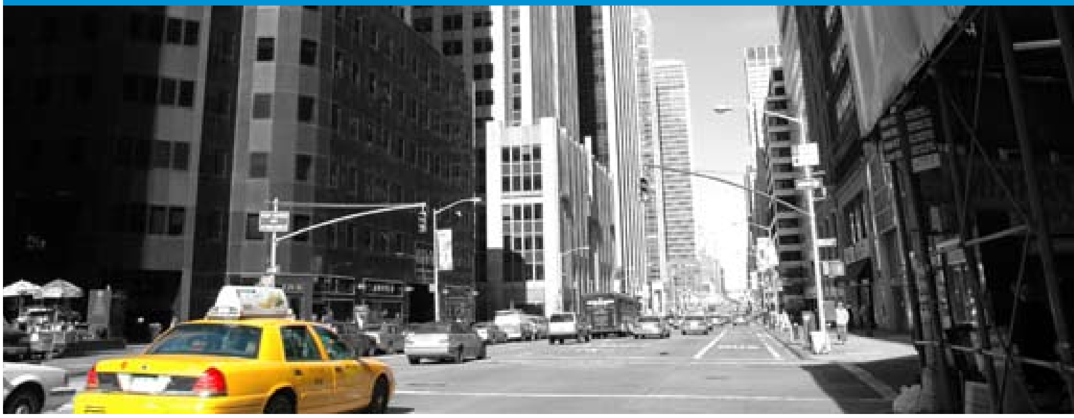

# Citigroup launches new reporting platform

**NEW YORK** 15.06.2010

Citigroup has launched Securities Finance Reporting (SFR), a next-generation reporting platform that delivers to clients a degree of transparency, flexibility and accessibility to business data previously unavailable.

Citi's SFR is a dynamic delivery system that, for the first time, enables clients to produce reports precisely tailored to meet their specific requirements. SFR allows access to all business lines enabling each client segment and function to retrieve the reporting they require.

"By far, the most significant client benefit of our Securities Finance Reporting system is its customisation capabilities," said Tim Douglas, global head of securities finance at Citi. "Now, SFR enables clients to work directly and interactively with their business data to create documents that satisfy their particular reporting needs."

Citi's Securities Finance Reporting delivers the following capabilities:

- Highly customisable, interactive reports that enable operations and financial client executives to see all securities lending, collateral management and cash reinvestment activities in their portfolios with the highest degree of granularity and transparency.
- Comprehensive variety of secure delivery methods, via CitiDirect for Securities, which enables clients to streamline their processes with straight through processing (STP).
- Best-in-class, scaleable technology to support clients' future growth.
- An inclusive selection of earnings reports that allow clients to understand and compare the profitability of their portfolios.
- A strong global organisation of dedicated SFR client delivery teams and local product and technology specialists in all regions.

## NEWS**IN**BRIEF

### Linedata unveils new functionality in LongView

Linedata Services has announced that it has introduced enhanced repurchase agreement ("repo") and collateral management functionality in its LongView trading platform. The move will allow the buy side to gain efficiency in managing overnight money across multiple custodial banks.

Linedata says this is a major advance for the buy side, where many firms have very little automation around both overnight cash management and collateral management functions. With this new functionality, Linedata Services aims to improve efficiencies and reduce costs in the continued evolution of cash markets. LongView's repo and collateral management functionality is unique because it significantly enhances the user experience while

read**more** p2

### SEC approves circuit breakers

The Securities and Exchange Commission has approved rules that will require the exchanges and FINRA to pause trading in certain individual stocks if the price moves 10 per cent or more in a five-minute period. The rules, which were proposed by the national securities exchanges and FINRA and published for public comment, come in response to the market disruption of May 6.

The rules are to be implemented with immediate effect.

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## INSIDE SECURITIES**LENDING**TIMES

## Linedata unveils new functionality in LongView

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removing the impediments that typically preclude repo processing on OMS systems.

On a daily basis, repo roll processing, the ability to "roll over" recurring investments in overnight cash day-to-day, incorporates collateralisation checks, providing a more fluent workflow.

"Linedata Services has always stayed on the forefront of technologies, functionalities and tools that make the lives of our clients easier, and improve efficiencies," said Gavin Little-Gill, global head of asset management product strategy for Linedata Services. "The new cash management functionality speaks to our commitment to our clients and highlights the significant investment in our fixed income and derivatives capability released over the past two years."

"Our clients' overnight money often ends up chasing basis points in the Tri-Party Repo market, for example. During the global crisis, clients recognised that they were having trouble with the daily monitoring of repo collateral against their cash investments," said Joe Kohanik, VP of fixed income and derivatives product management for Linedata Services in North America. "By working closely with clients we are delivering a solution that facilitates their workflows and enhances their risk mitigation toolset."

## SEC approves circuit breakers

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"The May 6 market disruption illustrated a sudden, but temporary, breakdown in the market's price setting function when a number of stocks and ETFs were executed at clearly irrational prices," said SEC chairman Mary Schapiro, who convened a meeting of the exchange leaders and FINRA at the SEC following the market disruption.

"By establishing a set of circuit breakers that uniformly pauses trading in a given security across all venues, these new rules will ensure that all markets pause simultaneously and provide time for buyers and sellers to trade at rational prices."

Under the rules, trading in a stock would pause across U.S. equity markets for a five-minute period in the event that the stock experiences a 10 per cent change in price over the preceding five minutes.

The pause, which applies to stocks in the S&P 500 Index, would give the markets the opportunity to attract new trading interest in an affected stock, establish a reasonable market price, and resume trading in a fair and orderly fashion. Initially, these new rules would be in effect on a pilot basis through to December 10, 2010.

The markets will use the pilot period to make appropriate adjustments to the parameters or operation of the circuit breakers as warranted based on their experience, and to expand the scope to securities beyond the S&P 500 (including ETFs) as soon as practicable.

"It is my hope to rapidly expand the program to thousands of additional publicly traded companies," added Schapiro.

At Schapiro's request, the SEC staff also will:

- Consider ways to address the risks of market orders and their potential to contribute to sudden price moves.
- Consider steps to deter or prohibit the use by market makers of "stub" quotes, which are not intended to indicate actual trading interest.
- Study the impact of other trading protocols at the exchanges, including the use of trading pauses and self-help rules.
- Continue to work with the exchanges and FINRA to improve the process for breaking erroneous trades, by assuring speed and consistency across markets.
- The SEC staff is working with the markets to consider recalibrating market-wide circuit breakers currently on the books - none of which were triggered on May 6. These circuit breakers apply across all equity trading venues.

## New mandates for J.P. Morgan

J.P. Morgan has been awarded a mandate to provide custody and related services to BankInvest, a leading asset manager and provider of investment funds in the Nordic region with $23 billion of total assets under management and administration.

J.P. Morgan will provide custody services to 28 listed investment funds managed by BankInvest with approximately $9 billion assets under custody. The mandate was awarded following a tender of both Danish and global custody providers. Previously, domestic Danish banks had acted as custodians to BankInvest.

Francis Jackson, head of business development for J.P. Morgan Worldwide Securities Services EMEA, said: "We are delighted that BankInvest has selected J.P Morgan to provide custody services. Our significant investments in technology, and the broad scope of our services, mean we are well positioned to serve BankInvest's complex requirements."

The bank has also been selected by the State of New Mexico to provide custody and securities services for the State's $40 billion assets.

New Mexico has four agencies: the State Investment Council, the Public Employees Retirement Association, the Educational Retirement Board, and the State Treasurer's Office.

J.P. Morgan will provide a range of services including: global custody, fund accounting, asset and alternative investment servicing, compliance reporting, foreign exchange, cash management and performance analytics.

"We chose J.P. Morgan because they offer the complete breadth of services we require. The firm scored well during the RFP committee evaluation of J.P. Morgan's proposal, based on the criteria established for the state's custodial service requirements. We are impressed with the strength of the firm, their commitment to the public pension market," said James B. Lewis, New Mexico state treasurer.

## Worst month since 2008

Hennessee Group LLC, an adviser to hedge fund investors, has declared May the worst month in over 18 months.

The Hennessee Hedge Fund Index declined 2.99 per cent in May (+1.57 per cent YTD), while the S&P 500 decreased 8.20 per cent (-2.30 per cent YTD), the Dow Jones Industrial Average declined 7.92 per cent (-2.79 per cent), and the NASDAQ Composite Index fell 8.29 per cent (-0.53 per cent YTD).

Bonds advanced, as the Barclays Aggregate Bond Index increased +0.84 per cent (+3.74 per cent YTD), due to increases in U.S. Treasuries as both Investment Grade and High Yield bonds declined.

"May was the worst month of the year for hedge funds and the worst monthly drawdown since October 2008. However, hedge fund managers avoided significant losses and outperformed traditional benchmarks on a relative basis due to conservative exposures, hedging and short positions," commented Charles Gradante, co-founder of Hennessee Group.

"In May, we saw investors significantly de-risk portfolios as volatility increased. Given the negative headwinds that exist and potential global crises, hedge funds continue to operate with low gross exposure levels as they navigate a challenging investment environment."

"Hedge funds' defensive positioning prior to May helped limit losses and provided downside protection," said Lee Hennessee, managing principal of Hennessee Group. "Downside protection is the primary benefit of the hedge fund asset class. In the current environment, where investors seem to be very skittish due to higher volatility and dramatic drawdowns, downside protection and hedges are extremely beneficial. We are seeing hedge funds garner continued interest by the investment community desiring lower drawdowns."

The Hennessee Long/Short Equity Index declined 2.81 per cent in May (+1.66 per cent YTD). The equity market "flash crash", the downgrade of European debt ratings, the Gulf oil spill, and the escalating tensions in Korea, spooked investors and triggered a flight to quality, namely US Treasuries. The equity markets experienced a sharp, broad based sell-off, giving back all of 2010 gains and leaving most indices in the red for the year. All 10 S&P sectors were in the red, led down by the energy sector (-11.8 per cent) as the BP oil spill put pressure on energy stocks.

Managers also lost money in the financial sector, as worries about European sovereign debt hammered financial services stocks.

## BNY Mellon to service German investment management industry

BNY Mellon is to provide derivatives collateral management services to the German investment management industry, via its DM Edge platform. DM Edge is a comprehensive derivatives margin management service allowing customisation of the margin and collateral process which incorporates the processing, reinvestment and valuation activities associated with posting and receiving collateral for OTC derivative transactions.

Jim Malgieri, CEO of Broker-Dealer Services at BNY Mellon, said: "More German funds now require collateral to be put in place with related swaps and the capacity to support multiple funds with different sub custodians is an important feature of the German market. DM Edge provides a valuable service to asset managers by delivering a scalable solution and providing clients with confidence in their ability to control the margin management process. We look forward to working closely with investment managers in Germany, supporting their collateral management function and helping to bring in further fund client business to assist the growth of their operations."

WestLB Mellon Asset Management, a joint venture between WestLB Asset Management and BNY Mellon, is the first German asset manager to begin to use these services. WestLB Mellon manages a large number of different funds with different custodians and therefore chose to a solution that could deliver the depth, breadth and flexibility of collateral management services for their operations, particularly in multiple depobanks/custodians.

## MarketMap finds Fame

SunGard is combining its Fame and MarketMap real-time market data solutions under the MarketMap brand to provide customers with a comprehensive suite of global, multi-asset information services. MarketMap is a market data, analysis and information services display terminal.

Fame's real-time solutions include global data feeds, components and alerts for consumption and integration with a range of applications. By uniting the data sources and infrastructures of both products, SunGard can offer customers a single relationship through which they can obtain a suite of global, real-time data and tools.

SunGard will continue to offer Fame Software for time series data management and related functions under the Fame brand.

MarketMap provides customers with a simplified framework, in a SaaS environment, for the rapid delivery of content to internal consumers and clients. MarketMap's feeds and other tools help improve efficiencies by offering easy integration into firms' trading engines, Web portals, back-office systems and other applications. The terminal also provides usage monitoring to help control data costs.

Gerry Murphy, president of SunGard's brokerage & clearance business, said, "Now that Fame's real-time data, alerts and components are united with MarketMap, customers can access the global data they require alongside tools that can help them increase transparency into market data consumption and manage their data spend accordingly."

## New platform reduces risk and increases efficiencies

BondLend's securities finance platform for the fixed income and repo community is now a month old, and the response from the market has been positive.

Over 30 participants drawn from both the lending and borrowing sectors were consulted during the development of the platform, which was initially developed with a focus on the US market but - because it is essentially a messaging platform - has also been rolled out to Canada and Europe, with Asia to follow in the future.

"The rationale for the creation of the platform was to create efficiencies in the fixed income and repo space," said Greg Harmon, fixed income specialist at BondLend. "We wanted to do so in a manner that not only took a lot of the workload away from the front, middle and back office, but also increased the accuracy of the data, reduced the amount of errors and improved the management of the information."

With minimising errors - and thus reducing risk - a key issue amongst participants, some in the industry were attempting to use non-sector specific technology to automate as many of their processes as possible. The new platform means there is now a system dedicated to the fixed income and repo market.

"Errors can be a big issue," said Harmon. "For example, the existing procedures of many firms involve looking at the overall picture of their position. So if they need collateral of 102 per cent and find they actually only have 101.5 per cent, the manager may decide they can get by with marking only three or four trades on their bigger positions. If the same thing happens over a series of days, within a week or two the portfolio will be seriously unbalanced and the errors have been compounded. With our Mark-to-Market service this is far less likely to happen."

As well as reducing the risks, automation reduces the costs for participants, said Harmon. "As customers start to embrace contract comparison tools on a day-to-day basis, instead of standard processing their middle and back offices will move towards exception processing - this could give them the opportunity to reallocate resources elsewhere."

And, continued Harmon, it reduces the cost of entry to the market, which may encourage new participants. "And although some people have the perception that if you're getting into a technology-based platform, then you need high levels of IT support. Some companies have more IT sophistication than others, but if you don't have the back-up that doesn't mean you can't use the system - if required, you can simply import and export your data using Excel."

In the weeks since the launch of the platform, the feedback has been excellent, says Harmon. "The response has been stellar. Every client we have been in contact with has embraced the principle of contract comparison and mark to market."

## Eurex trading growth continues

At the international derivatives markets of Eurex, an average daily volume of 16.2 million contracts was traded in May (May 2009: 11.8 million). Of those, 12.2 million contracts (May 2009: 7.4 million) were traded at Eurex; another 4.0 million contracts (May 2009: 4.4 million) were traded at the International Securities Exchange (ISE).

The strong increase of Eurex turnover of 65 per cent year-on-year is due to the increasing use of exchange-traded and centrally cleared derivatives in the current market environment, which was driven by high volatility and uncertainty as well as the dividend season.

In total, 335.7 million contracts were traded on both exchanges compared with 237 million contracts in May 2009, which is an increase of 42 per cent. On 6 May a new daily turnover record was achieved with 25 million contracts.

At Eurex, the equity index derivatives segment totaled 101.4 million contracts (May 2009: 56.2 million). The future on the Euro STOXX 50 was once again the most successful product with 47.7 million contracts; the Euro STOXX 50 option achieved another 38.0 million contracts.

Dividend derivatives traded more than 543,000 contracts, while the volatility derivatives recorded almost 218,000 contracts for both VSTOXX futures and options.

## Clearstream's custodial assets rise in May

In May 2010, the value of assets under custody held by Clearstream on behalf of customers registered an increase of seven per cent to €10.9 trillion (compared to €10.2 trillion in May 2009).

Securities held under custody in Clearstream's international business experienced a rise of nine per cent from €5.4 trillion in May 2009 to €5.9 trillion in May 2010 while domestic German securities held under custody increased by four per cent from €4.8 trillion in May 2009 to €5 trillion in May 2010.

In May 2010 3.37 million international transactions were processed, a 28 per cent increase over May 2009 (2.62 million). International over the counter (OTC) bond transactions grew by 16 per cent from 1.51 million to 1.74 million in May 2010. Of all international transactions, 71 per cent were OTC transactions and 29 per cent were registered as stock exchange transactions.

On the German domestic market, settlement transactions reached 8.11 million, 37 per cent more than in May 2009 (5.92 million). Of these transactions, 69 per cent were stock exchange transactions and 31 per cent OTC transactions.

For global securities financing (GSF) services, the monthly average outstanding reached €509.6 billion in May 2010. The combined services, which include triparty repo, securities lending and collateral management, collectively experienced a rise of four per cent over May 2009 (€ 489.8 billion).

In the investment funds services, 472,291 transactions were processed, a 61 per cent increase over May 2009 (292,502).

## Access Malta

Malta Stock Exchange (MSE) and Clearstream intend to offer settlement for Maltese domestic securities by working closely together with the aim to improve cross-border settlement ahead of the implementation of Target2-Securities, the settlement system that the European Central Bank plans to introduce in 2014 for cross-border settlement. Both parties plan to have a solution in place in the next twelve months.

Clearstream and the MSE will offer settlement in Clearstream via the Maltese Central Securities Depository (MSCD) for all types of Maltese securities (stocks, Government securities, investment funds) against Central Bank money.
Mark A Guillaumier, chief executive at MSE said: "Clearstream Banking is a leading institution in the area of international settlement and the Malta Stock Exchange is delighted to participate in this joint project aimed at facilitating international business on our market".

Andreas Wolf, CEO, Clearstream Banking AG, Frankfurt said, "We are very pleased to support Malta in offering international investors' access to Maltese domestic securities. Our solution will provide a flexible, efficient and appropriate access to the Maltese market."

# In Association

**In advance of the annual ISLA conference in Berlin, ISLA's Kevin McNulty speaks to SLT**

**SLT** EXCLUSIVE

## SLT: How do you feel the securities lending industry has withstood the downturn?

**McNulty:** Generally, the market has fared well. It has survived as a business and it remains very much a live business. It survived the Lehman collapse and even though lenders had large exposures most lenders didn't lose money. If there was a black spot it was cash collateral, where some lenders have lost money. This impact was greater in the US, of course, where cash collateral makes up more than 90 per cent of the market. In Europe the impact was lower, but it did mean that the beneficial owners in Europe who historically took cash collateral had to take another look at their strategies.

The Lehman failure showed that market conventions served the industry well in terms of credit control and risk management practices. After Lehman, the industry took a step back and focused on the risks, constraints and controls.

## SLT: You became chief executive last August. Was the market still in the eye of the storm, or had the worst already happened?

**McNulty:** The worst of the turmoil had mostly worked itself out. Since I took the helm a very large part of our focus has been working our way through the vast amounts of literature coming from regulators

## SLT: How do you feel the regulatory environment will change? Is there anything industry participants should be wary of?

**McNulty:** We've seen activity designed to prevent naked short selling in Germany and France and we know for sure that something is going to happen covering this area .

We also expect some changes to the rules around transparency and possibly around cash collateral, although the latter seems less likely now. We are seeing demand in some parts of the world for reporting of securities lending transactions to become more transparent and public.

## SLT: What are your views on a pan-European regulatory environment?

**McNulty:** We strongly believe there should be a harmonised EU view on regulation. We started the year with the belief that there would be a pan European approach to short selling but we have seen countries go it alone.

This view isn't just held by us; the European Commission also wants to see it. But we're some way from harmonisation. CESR looked at short selling regimes across the EU and commented there had been an uncoordinated approach to it through the crisis. We were optimistic that this would happen at the start of the year but we're not seeing it yet.

## SLT: What has ISLA been able to do to ensure the securities lending industry has thrived over the past couple of years?

**McNulty:** We've been busy! Firstly, we've produced a paper that gives an academic view of short selling to help people understand that it's really not a bad thing. We've also designed information for beneficial owners to explain securities lending - how lending programmes work, the risks associated with securities lending and what happens in the event of default.

One of our main roles is to provide a forum for our members, to discuss face-to-face, over the telephone or electronically, issues of common interest and act as a sounding board.

We also have quite a bit of contact with regulators. We've been talking to the FSA, particularly on the subjects of increasing understanding amongst beneficial owners and on custody banks running securities lending programmes. We're also regularly in touch with CESR regarding short selling, Corporate governance and transparency, and we have had dialogue with other regulators like the AFM in the Netherlands .

The regulators themselves are always very interested in the views of the industry, but they are often caught between a rock and a hard place - while they want the best practices for the industry, political motives can sometimes come into play, which affects the work they do.

## SLT: How closely do you work with the associations in Asia and the US?

**McNulty:** We have a good dialogue with the RMA and PASLA but this tends to be driven by the issues that arise - we talk when things happen and work together when it makes sense

## SLT: While it has never been at the top of the headlines in the mainstream media - in the way derivatives or MBS have - has the reputation of securities lending been harmed during the downturn? Has it led to firms - especially the beneficial owners - taking a more conservative approach?

**McNulty:** Hopefully this is a good thing - because it's not a problem it's not taking top priority in the eyes of the regulators, governments or media. And while, for example, the FSA believes more beneficial owner awareness is necessary, it wants the industry to self-police wherever possible. That said, there is no doubt that beneficial owners are continuing to take a conservative approach.

## SLT: Is there enough knowledge amongst beneficial owners?

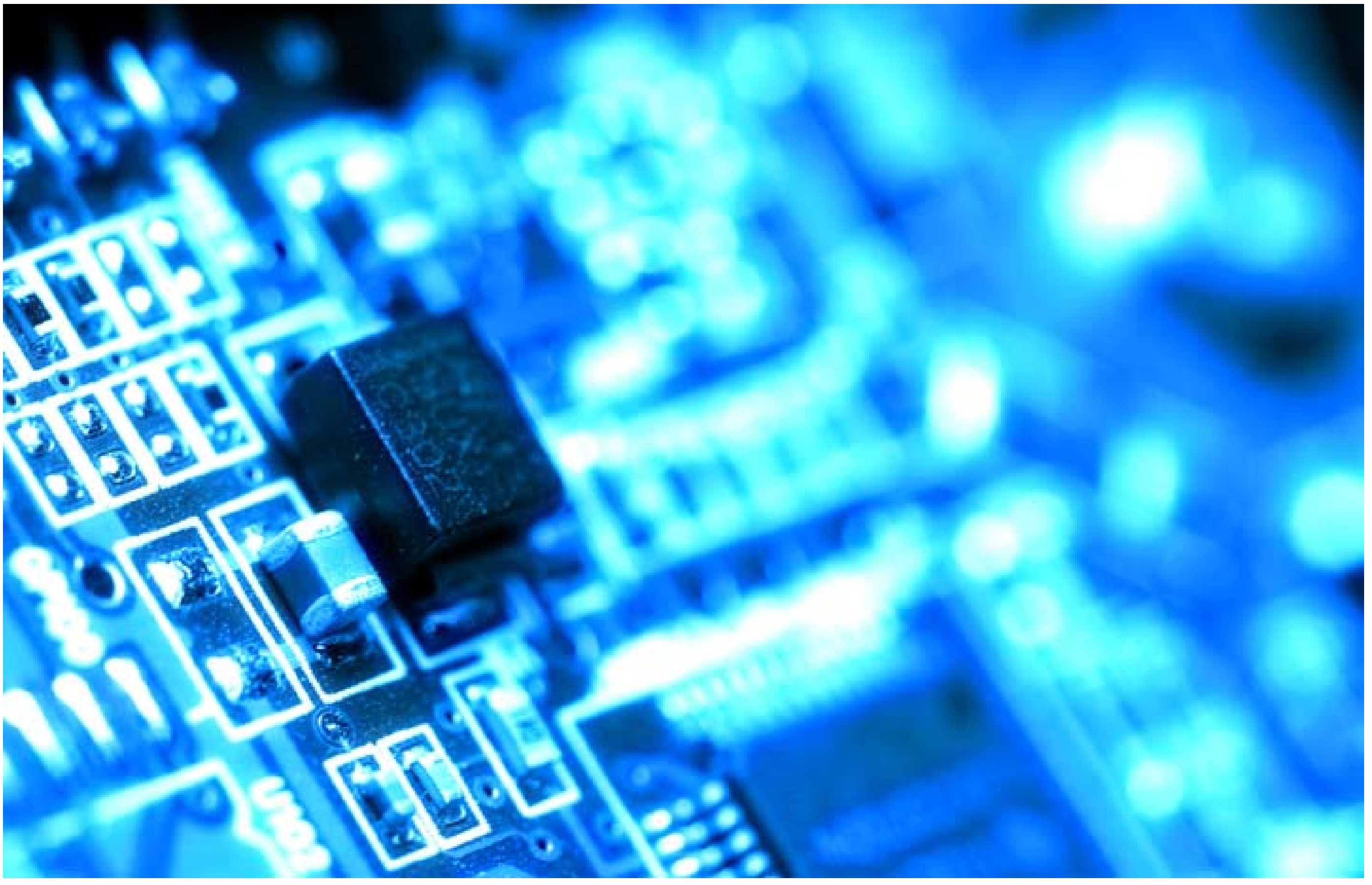
**McNulty:** We do think there are some beneficial owners who need to know more. It's not a problem unique to securities lending, it affects the whole investments industry - these funds have a lot of financial instruments to deal with and if you're a trustee of a pension fund with limited investment experience it's not easy to learn about everything. We are working with other trade association on a concise guide to help beneficial owners understand how the business works.

## SLT: What are your ambitions and hopes for the future?

**McNulty:** For the market as a whole we'd like to see things settle down and the disruptions dissipate. We'd also like to see a regulatory regime that is reasonably globally consistent come into force.

From the point of view of ISLA, we'd like to develop an educational programme for participants. We're already in the early stages of this development and have plans to roll out a more comprehensive service.**SLT**

Kevin McNulty is the chief executive of the International Securities Lending Association. He has worked in the securities lending industry for many years both in the UK and the US. Prior to joining ISLA in August 2009, he worked for Barclays Global Investors, where he ran the securities lending business in Europe and North America. Kevin is a past chairman of the Association and a fellow of the Association of Chartered Certified Accountants.



# The advantages of a consolidated technology framework in securities finance

Reducing risk and increasing efficiency within securities finance can only be achieved with a consolidated technology framework argues Jane Milner, who is responsible for securities finance and business development at SunGard Capital Markets and Investment Banking

**SLT** EXCLUSIVE

Technology has become a key driver to success in securities finance. A firm's ability to positively transform its business in terms of strategy and workflow can be constrained due to limitations in technology, making it difficult for the business to evolve. Technology solutions that have the flexibility to support new business models with accurate, consistent information at the core will provide firms with true value and staying power for years to come.

Improving efficiencies and driving down costs are main priorities for most business managers today. In securities finance, where the variable nature of trades and the complexity of the operational lifecycle creates many challenges, the consolidation of technology and information can help firms optimise operations across trading desks and business entities.

## Optimising technology

Today, most firms appreciate the cost and efficiency benefits of consolidating information and systems across areas of their business that have similar functional requirements, while at the same time maintaining segregation of information specific to duties, business activities, or legal entities.

However, many firms have invested heavily in their current technology infrastructures, but over time they find themselves struggling to keep their legacy and proprietary systems up to date with new business requirements, industry standards, and transaction volumes. When considering new IT solutions, firms are seeking solutions that allow them to balance the richness of standard vendor-supported functionality, while at the same time allowing them to integrate these standard components with key elements of their existing proprietary development that give them a competitive advantage. To do this, a firm must select a solution that has a flexible and open systems architecture, which can be incorporated within their existing in-house infrastructure, providing them the opportunity to benefit from ongoing utilisation of their own internal expertise and resources.

## Bridging the gaps across silos

Financial organisations are increasingly seeking more effective ways to handle multiple product lines and geographical locations dispersed around the globe, allowing them to "pass the book" across different entities, ensuring that the firm's inventory works harder and the range of counterparties is maximised.

Today, in securities finance as well as other areas of the business, an organisation may have separate business desks for equities, fixed income and derivative products within each geographical region, which results in silos of information and disparate systems. More and more firms are seeking ways to consolidate business activity and share resources and information in order to make the most effective use of a firm's assets, both across products and geography. Where this is the case, firms benefit from solutions that cater for the full range of securities finance requirements using a single IT solution. Such a solution should have the flexibility to choose component-based functions that meet immediate business needs as well as support future needs. While many firms face challenges with this type of consolidation due to the changes that this involves, having solutions that accommodate a range of requirements supports a gradual move to a consolidated structure through a phased approach.

Consolidated and integrated solutions also help firms reduce operational risk and costs with the ability to leverage processing workflows and synergies between functional silos throughout the organisation. Such solutions can facilitate automation of intra and inter-entity transaction processing between silos that may currently be time consuming and error prone. At the same time costs are reduced by managing transactions on a single platform in order to gain economies of scale.

## Enhancing transparency

Consolidated technology frameworks provide an infrastructure of centralised information, giving firms access to an aggregate, holistic source of real-time information to enhance transparency across the organisation. Increasingly, there is greater recognition of the importance for management to have a single view of data across the business. For example, risk and compliance managers want to be able to see a single firm-wide exposure to a counterparty or security.
Consolidated systems not only provide holistic views of activity within the organisation, through integration with external market data, they can also provide the ability to leverage the data to improve analytics and further improve transparency.

## Improving efficiencies

Real-time, consolidated securities and cash positions can be combined with analytical market data to strengthen traders' ability to place the right trade at the right price at the right time. These efficiencies also give traders more time to pursue lucrative specials, exclusives, and sophisticated trading strategies. Some market players are also looking to extend their trading capabilities with electronic securities lending markets, such as Quadriserv's AQS, in order to provide firms with extended utilisation of securities available for lending. Although electronic marketplaces offer additional liquidity and access to a broader range of counterparties, they also provide challenges in terms of avoidance of dual asset usage, and integration with existing operational solutions such as settlement processing and accounting. Solutions that already have close integration with these new electronic trading venues remove many of these issues.
Through close integration with market data analytics, a trader looking to lend or finance a particular security can benefit from seeing supporting information such as aggregated market availability, on-loan volumes and rate information, providing an indication of demand and potential pricing for that security, and allowing them to make more informed trading decisions.
A consolidated solution improves the workflow among the front, middle and back office functions, and can bring increased efficiencies to support streamlined business process management with integrated exceptions management for quick problem resolution.

## Reducing risk with enterprise collateral management

The need to maximise liquidity and capital efficiency has brought collateral management into sharp focus. Consolidation of an organisation's assets across products and geographies is key to achieving effective, global collateral management. Enterprise collateral management groups are being formed to service the traditionally separate lending, repo and derivative desks, thereby enhancing the use of securities and cash portfolios across the firm. Many firms are finding, however, that the individual systems used by each desk do not integrate easily to allow them to bring this information together. A consolidated technology framework to support all securities finance product types will alleviate these issues, and also give a better view of bank-wide view of risk.

## Increasing flexibility

More than ever before, firms need to be agile when launching new businesses or strategies. IT solution providers that offer a rich mix of functionality, along with flexible integration capabilities using a selection of industry standard technologies for the integration of firm-specific functionality, will help firms to quickly leverage system components for use by multiple business areas.

Flexibility of reporting and data extraction, whether to address the ever increasing regulatory and compliance demands or to respond to internal and external customer requests for information, are also key. Consolidated solutions that address a broad, aggregate range of business requirements can help facilitate the process of bringing together the necessary information to more efficiently meet new and existing reporting requirements.

Organisations that tap into a consolidated technology framework with an open architecture and flexible integration capabilities place themselves at a significant advantage. Access to consolidated information can help drive process improvements, increased efficiency and transparency, and provide the scalability needed for the future while helping to control risk and cost. **SLT**

Jane Milner, securities strategy and business development, Sungard Capital Markets and Investment Banking

# Germany

## Conservative in regulatory terms and investor behaviour, Germany's securities lending market has to fight to get its voice heard

**MARKET** REPORT

The German securities lending and repo markets are a significant part of the wider European market.

German government bonds are considered high quality and highly liquid collateral and are very desirable. There is a lot of activity surrounding them and increasingly so in a market dominated by a desire for high quality assets.

German investment culture tends to be very conservative as is the German regulatory authority, the Bundesanstallt fuer Finanzdienstleistungsaufsicht (BaFIN). Its hedge fund community is, consequently, very small.

"Hedge funds are not a big topic in Germany," says Arne Theia, head of Repo and Collateral Trading at UniCredit. "There is no significant hedge fund community in Germany because there are so many, many requirements involved in setting up a hedge fund. Therefore hedge funds prefer less restricted locations outside Germany. Also, German investors and customers are very conservative and are cautious about hedge funds. They tend to go to conventional asset managers or even the Exchange Traded Fund (ETF) business."

The lending market is also fairly restricted. The German Investment Act, article 56, doesn't allow asset managers, Kapital Anlage Gesselschafte (KAG) to lend more than 10 per cent of their holdings to any one counterpart. KAGs have to find 10 separate counterparts to lend out a full portfolio.

An exception to this rule, however, is that if you lend through a BaFin qualified "organised system" you can lend beyond the 10 per cent limit. Clearstream Banking Frankfurt is the only company to have been awarded this official stamp. An "organised system" essentially means that BaFin is convinced that at any given time the organisation will make sure that a loan is collateralised and will not cause any harm for the asset manager or underlying investor, in case of default, simply because there would be enough collateral in place.

It is interesting, however, that this historically restrictive and conservative environment could have produced a market environment that is to some extent demonstrative of the future of securities lending and repo, where third party agents who can manage collateral almost in the manner of a market utility could give the market security and therefore life.

Since the beginning of the financial crisis, Theia observes markets have evolved significantly. "During the liquidity crisis there was a shift from unsecured to secured financing," he says. "Unsecured money market models collapsed and the markets in general were looking for deeper protection. Securities lending and repo markets provided a secured option. They are, therefore, without doubt, winners of the financial crisis."

In terms of market size, Europe repo is much bigger than the European securities lending market. A recent survey from the International Capital Markets Association (ICMA) shows that the European repo market has a current volume of around EUR 5.6 trillion, whereas the US has a volume of USD 4.5 trillion. It also shows that within Europe repo is 85 per cent of the market and securities lending 15 per cent.

Theia says: "In terms of size the repo market is much bigger than the securities lending market in Europe because repo has become the main refinancing product. As the unsecured money markets get more limited and expensive the secured repo product became the way that banks managed liquidity and collateral and it is now the predominant method."

Gösta Feige, global securities financing sales manager at Clearstream, agrees. Clearstream Banking is a collateral agent so by its nature, would only see collateralised transactions. However within this context it has seen a clear increase in [collateralised] transactions.

"We see a clear increase in triparty transactions as the trend goes towards collateralising almost everything," he says. "We see the unsecured money market disappearing and being replaced by the triparty repo market. It is the same for securities lending, whatever transaction we see is collateralised," he continues. "The lenders of securities dismiss any unsecured lending whatsoever, and in all secured lending they have a close look at the collateral they are getting. They also have a lot of questions about the procedures we apply surrounding haircuts, price age, concentration limits, also our background and who we are. They want to know if we are neutral or if we have a market interest."

Maria Carina, director of securities lending and borrowing services at Euroclear adds: "Repo is a very interesting instrument because it is a secured way of financing. Ever since the financial crisis began, there has been a bigger push towards secured financing transactions and repo is an instrument that can help clients to secure these types of transactions. One of the market developments that we have seen since the crisis is that more corporates and insurance companies, as well as money market funds, are using triparty agents to manage collateral movements relating to repos because of their secured characteristics."

The ICMA survey also shows that while the market decreased during the financial crisis it has recovered by about 20 per cent this year. According to Theia, the trend in this market is towards high quality collateral that is liquid in the secondary market, so that in case of counterparty default you are able to execute your collateral in the markets.

People are looking for government paper, covered paper and even equities," Theia says. "Equities that are traded on a stock exchange are welcomed as an asset class because you get a market overview of their value – what they are worth. Market infrastructure is also booming – people are far more interested in doing business through central counterparts at a clearinghouses or through a Triparty Agent because it reduces operational risk and bilateral risk."

Carina agrees: "Collateral helps you to cover risks and exposures, but the collateral itself is also a source of risk, meaning that you have to value and manage the movements of collateral to reflect changes in the market. The role of a third party agent to deal with these aspects of collateral management is very important and will become even more important."

So, while secured products like repo and securities lending have remained popular options with original market participants, they have also become increasingly popular options outside of the market.

> The lenders of securities dismiss any unsecured lending whatsoever, and in all secured lending they have a close look at the collateral they are getting
>
> Gösta Feige

Denis Peters, director, corporate communications at Euroclear, says: "we have seen a greater variety of entities exploring how Euroclear Bank, as a triparty agent, could help them manage their collateral requirements than ever before. The growth we are experiencing is not only a matter of more and more activity coming from the same entities, but a diversification of the type of entity that is interested in outsourcing to an agent like Euroclear Bank."

Although secured products are the seeming winners of the liquidity crisis the regulatory environment has changed. Regulators and central banks have put increased pressure on banks because they want to avoid another capital crisis. One major influence comes from the United Kingdom's Financial Services Authority (FSA), which has proposed that banks should raise capital to create "liquidity buffers," which means banks should have enough liquid assets available to survive a 30 day stress scenario. The liquidity buffer must therefore contain high quality and highly liquid paper.

Theia explains that many people consider this a problem. The only asset class that could match these kinds of requirements are well-rated European government bonds. He thinks that the regulation would create a new "regulator approved" asset class and that this would have a huge impact on the securities lending and repo markets.

"The problem here is that if the regulators define what is high quality it could lead to a fragmentation in the market between "good" and "bad" quality," he says. "This has an impact on the owners of the paper and the secondary market. If there is a run for prime assets then everyone has to buy them in the secondary market, which means that there will be an even lower supply. This doesn't exactly relax the situation in the bond markets. What will happen to issuers not matching the requirements of the regulators? Financing will clearly get more difficult and expensive for them.

"Managing collateral and liquidity is now considered to be key in surviving the financial markets which in general means a big push for securities lending and repo, however departments are now working in a much tougher financial and regulatory environment. Banks will have to adjust their business model and it will be much harder to make a profit, as they will have to pay for regulatory requirements and the increased capital costs.

"The entire banking industry has had to face the liquidity crisis, but the next stage will be institutional customers. Asset managers, insurers, and even a lot of corporates will need collateralised protection in order to provide liquidity. This will provide a big push for the securities lending and repo markets."

Another significant impact on the market is the European Central Bank's (ECB) monetary policy. In July 2009 the ECB offered a one-year refinancing operation in which they pumped EUR 440 billion into the financial market system, lending at one per cent. Since then the market has been facing a huge liquidity surplus and people and banks are now happy just to find a home for the money. "This has had quite a huge impact on the sec lending and repo markets," Theia explains, "because spreads within ECB eligible assets have more or less disappeared on a daily basis. People want to invest the money but are only willing to do so in a secured way, so they do it in the repo market. This has also been a push for this market."

Feige says: "The effect of the ECB actions means that many houses who have been participating in these auctions, now have an issue of how to reinvest the cash. They don't want to reinvest it unsecured which is why they put in place collateralised reinvestment schemes like triparty repo."

The one-year basket will close in July and it will be interesting to see the reaction of the market.

Feige says: "Houses are preparing by looking at collateralised solutions rather than just relying on the central bank. There are assets for example that one can't re-finance with a central bank, but that could potentially be re-financed in the inter bank market. So they are setting up triparty solutions in order to be sure they have sufficient options to re-finance themselves."

Liquidity is in any case still clearly a priority for the ECB. It recently announced two other options: a three month tender with full allotment at a fixed rate and a six month tender with full allotment at a minimum bid historic average rate of the weekly repo. Also, the ECB will continue accepting GR collateral. **SLT**

# Managing through turmoil

## What are the expectations for securities lending, asks Yvonne Wyllie, head of securities lending at RBC Dexia

**MARKETS**

The securities lending business is all too familiar with extremes. From available asset pools to revenues to the number of programme participants, the pendulum continues to swing. But securities lending has proven to be rather resilient in the face of volatility. And despite the challenges, growth opportunities exist and can expect to be realised, over time.

We appear to be at a fairly low point in the cycle, marked by lower outstanding balances, fewer market participants executing the trades that drive demand, and a lack of merger & acquisition (M&A) activity. Year-over-year, however, there are still gaps. Rights issue activity has dropped, revenue from specials has declined and M&A activity is at its lowest point in approximately seven or eight years. Nonetheless, we expect to see modest growth through the remainder of 2010 and beyond. But recovery can be a slow, inconsistent, cautious climb.

> For a CCP in this industry to truly be successful, it also requires the co-operation and collaboration from prime brokers and agent lenders

General collateral (GC) activity is slowly returning and if market values rebound, again, so will overall revenue generation. Furthermore, the supply side in the market has shown increasing signs of improvement. Lenders who had temporarily suspended their lending programs during the credit crisis returned after adjusting program parameters to better suit their risk-reward profile. And there is growing interest to lend from new funds.

The demand for fixed income securities has been dampened by a very low interest rate environment, flat yield curves, and inexpensive central bank financing. However, as interest rates begin to rise, speculation increases and low-cost financing starts to be withdrawn. As a result, we expect demand to gradually increase through the rest of the year. If the double-dip recession theory doesn't become a reality, the outlook for next year is more positive.

## Is CCP set to become a reality?

Central counterparty (CCP) has been a common topic of discussion within the industry for quite some time, but now appears to be gaining traction. The concept of a securities lending CCP is fundamentally sound, and the overarching benefits are clear from their application in other financial markets. But the challenge for most is in developing a thorough understanding as to how it will work in practice and in identifying the inherent risks within the context of a securities lending environment.

Which markets or asset classes will lend themselves more readily to the model, and which providers will have the depth of participation to create the liquidity needed? There is resistance in the industry from both lenders and borrowers. The lender currently has control of limits, collateral and margins but once this is handed over to the CCP, it is unclear as to the scope of responsibility. There also needs to be a deeper understanding of how to measure risk in this model.

Cash collateral remains a legitimate option for lenders to consider, but has its own risk return profile that must be clearly understood

In the current environment, where regulators are looking at securities lending with greater scrutiny, the relative transparency that CCP offers versus OTC products can be considered attractive attributes of the model. However, until there is broader acceptance from regulators or beneficial owners, the CCP model will not likely be adopted by the majority of industry participants anytime soon. For a CCP in this industry to truly be successful, it also requires the cooperation and collaboration from prime brokers and agent lenders—and we haven't progressed to that stage.

## The cash/non-cash collateral argument

Currently, we are seeing a push from borrowers for more flexible collateral grids. As the collateral preference from borrowers can change from cash to non-cash, lenders have to become more flexible in accepting both types of collateral. Regardless, it is important that the risk return profile is understood and professionally managed. The key for any lender is to actively manage, monitor and review their own policies and procedures and, where applicable, clearly communicate them to their securities lending providers. Collateral flexibility from lenders is highly valued and those who can accept a broad range of non-cash collateral have been rewarded with higher utilisations.

Cash collateral remains a legitimate option for lenders to consider but has its own unique risk-return profile that must be clearly understood. It is not intrinsically safer or riskier than securities. The primary risk involved in cash collateral centres on the approach, conservative or otherwise, to reinvestment (eg., for what duration, in what instruments, on a segregated or pooled basis, etc.). If a lender accepts cash as collateral, their cash reinvestment parameters must be clearly defined.

The cost of collateral has been the deciding factor on GC loans for the last two years, and it is likely to remain status quo. What may change is our view on margin requirements. The simple 102 per cent or 105 per cent margin requirements are no longer standard market practice, particularly with today's increased emphasis on VaR analysis combined with volatile markets. Loan and collateral correlation will become increasingly important as a means to reduce risk and, if the market can establish a practical way to manage it, variable margins will become more common.

## Regulatory influences

Regulators around the world are discussing securities lending more than ever before and this can be considered one of the more positive outcomes of the financial crisis. It has provided securities lending providers and participants with the opportunity to clearly articulate the features and benefits of securities lending in a more transparent environment. And ultimately, better informed regulators are apt to make more relevant and appropriate decisions regarding securities lending regulation and oversight.

Despite the challenges the industry has faced over the past several years, the business is proving resilient and the forecast is showing promise. **SLT**

# Capitalising on collateral

## Euroclear's Frank Reiss explains the measures beneficial owners are using to protect their assets

**SLT** EXCLUSIVE

Our capital markets have started their journey to recovery. It is inconceivable that we will be returning anytime soon to the pre-crisis environment where, for example, unsecured lending was prolific, cheap financing can be found just about anywhere and asset-backed securities accounted for the lion's share of all collateral in use. The financial meltdown has spawned a new breed of firm – where risk and cost controls are front and centre, rather than with a focus on short-term yields.

Today's global financial market is a very different place. Counterparties are scrutinising their trading partners, even examining the potential liabilities these entities have towards other firms. Some have chosen to leave certain businesses, such as securities lending, while others remain. Caution is the watchword. As a result, firms are even more concerned about the assets they are willing to invest in or agree to take as collateral in financing transactions.

As a neutral third-party collateral manager, one interesting trend that we have noticed recently is that some beneficial owners are asking their agency lenders to deposit collateral in their own direct accounts, rather than through the agent's omnibus account structure. The agent remains in control of the financing transaction on behalf of its client, but the collateral movements conducted by the triparty service provider are either directly in and out of the beneficial owner's nominee account or pass through the agent's account. Thus, by having direct ownership of the collateral, the beneficial owner mitigates default risks vis-à-vis the counterparty and its agent at the same time.

### Pricing precision

Collateral liquidity has become an absolute essential. Taking collateral to reduce exposures, of course, is an important step in reducing risk, but valuing collateral accurately and having the ability to liquidate these holdings as and when necessary is equally crucial.

In bilateral financing deals, administrative responsibilities such as accurately valuing the underlying securities used as collateral, establishing and adjusting haircuts and, when needed, substituting securities used as collateral is a rigmarole that most firms see as a non-value-added burden. Furthermore, it eats up valuable resources. In our new cost-conscious world, more market practitioners are looking to their infrastructure service providers to bypass these burdens and unlock the powers of automated collateral management.

Euroclear Bank, as an international central securities depository managing around EUR 250 billion in collateral outstanding per day, already supports clients active in repos, secured loans, derivatives and securities lending transactions. Our fully automated service caters for a variety of fixed income, equities and hybrid collateral. Amongst other tasks, we perform daily mark-to-market valuation checks to ensure that the transaction is fully collateralised at all times.

Our pricing is fresh. Because we settle transactions in over 400,000 securities, we are able to cross-check and supplement third-party price feeds with data derived from our own real-time transaction settlement process. This gives us the ability to frequently and accurately provide on-demand collateral valuations.

Adaptability is also a service cornerstone. For example, simply by defining as such within pre-arranged collateral eligibility criteria, collateral takers can exclude price quotations for collateral that are older than a certain period, or completely rule out prices that have been formulated according to a synthetic pricing model. Concentration limits, currency selections, paper grade, amongst other criteria, are all respected by the triparty service provider. And eligibility criteria can be changed on an intra-day basis.

In view of the above, we are not surprised to see increased use of equities as collateral as another recent trend. From a pricing perspective, it is relatively straightforward to get current and accurate equity prices from an array of credible sources, exchanges, Miffs, data vendors, etc.

## Quality is king

In today's market, cash lenders are tightening valuation criteria and narrowing concentration limits on the securities they accept as collateral, thereby forcing borrowers to supply a diversified selection of higher quality securities as collateral.

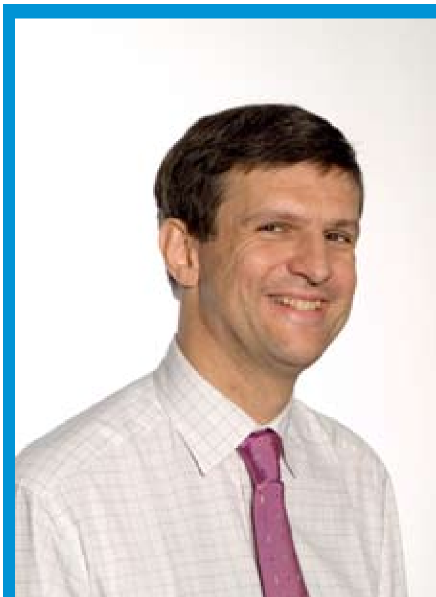
Furthermore, to extend the use of collateral even further, collateral takers may re-use securities received as collateral from one deal and pledge them in another financing operation, thereby gaining new profit-generating opportunities.

Another trend we are seeing is a growing appetite for trans-continental financing. For example, we are supporting market participants in Europe and Asia to use the international and domestic securities they hold in Euroclear Bank to finance repos and other transactions involving European and major Asia-Pacific currencies. More and more Asian firms are using their Japanese government bond (JGB) holdings as collateral for financing purposes with Europe-based counterparties. They are able to pledge JGBs as collateral at the end of the Asian business day and have full use of these securities at the start of the next business day in Asia. Korean government debt is also growing in use as collateral since Euroclear Bank launched a link with the Korean securities depository in September 2009.

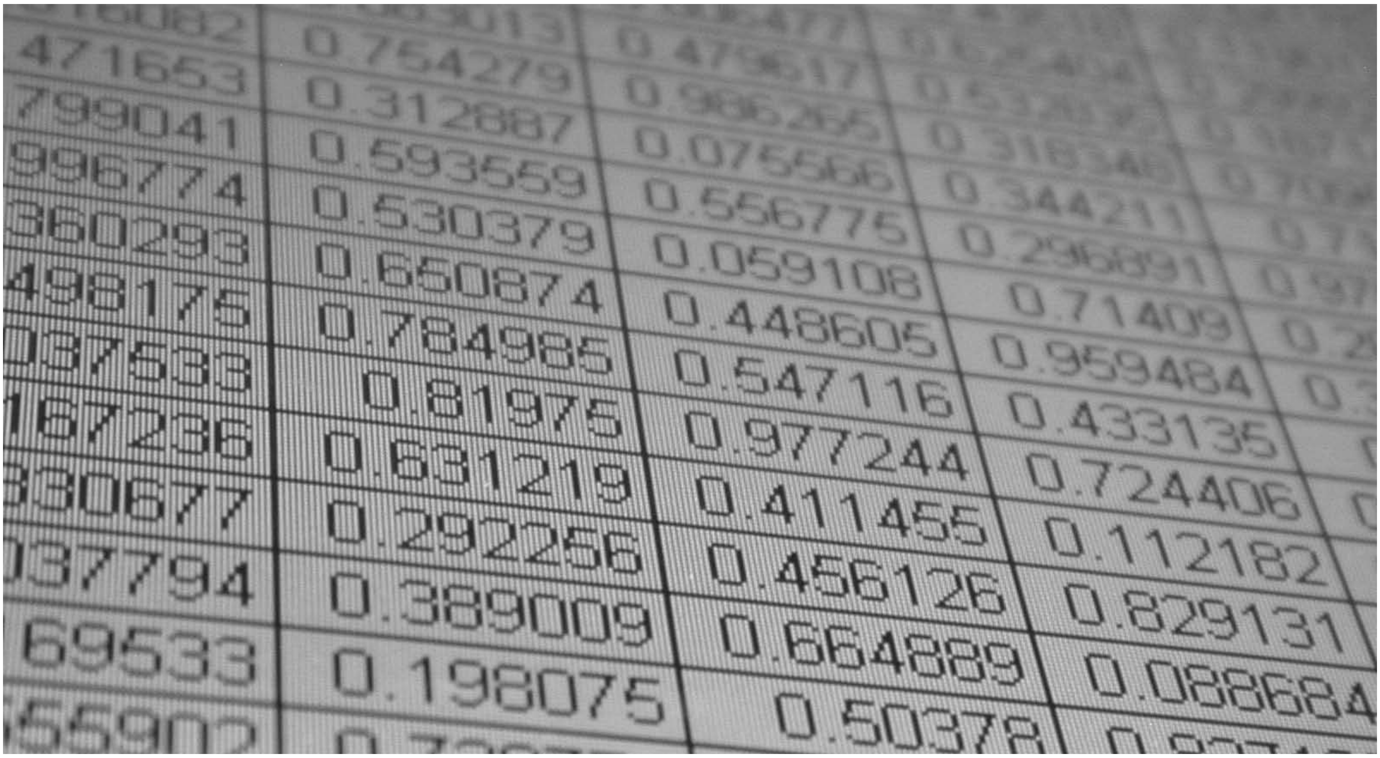
## A safer future

National central banks and market infrastructure service providers have been pivotal in guiding firms through the worst of the financial storm. Their "safe haven" status kept liquidity flowing.

Throughout the crisis, there has been a flight to quality – not only in terms of investments, but of business partners as well. Low-risk, proven service providers, highly liquid and easily valued assets, as well as expert triparty agents have been in sharp demand. And central banks move forwards on their planned exit strategies as liquidity providers, it is likely that their collateral criteria will tighten at some point. This should force the inter-bank market to increase commercial lending activities, albeit on a fully secured basis. Those firms already using neutral triparty collateral agents can face the future with greater certainty. **SLT**



Frank Reiss, director, head of collateral services, Euroclear




# The future of the market

## Securities Lending Times interviews Allen Postlethwaite, CEO of SecFinex, about the current market and the challenges it faces

**SLT** EXCLUSIVE

### SLT: Allen, given the negative publicity around short selling in the equities markets over the last two years and the reduction in SBL volumes, do you feel that the industry will inevitably decline?

**Postlethwaite:** Much of the negative publicity has been ill-directed by those wishing to identify a villain responsible for the banking crisis. More careful analysis of the motivations of stock borrowers shows that the desire to hedge risk rather than to create it is the key driver of the market. My opinion is that as the market stabilises, hedge funds begin to use leverage, and short selling restrictions are lifted after proving ineffective the SBL market will regain some, if not all, of its momentum.

### SLT: But isn't it true that the various regulators, for example in Germany, have put limits on SBL, which will adversely affect the industry?

**Postlethwaite:** Short term restrictions on SBL are nothing new; you will remember the restrictions on shorting financial institutions put into place in the UK and USA in 2008/9. The experience so far has been that regulators quickly realise that the damage to liquidity caused by such restrictions far outweighs the theoretical benefits of holding up the share prices of financial institutions. So while restrictions on SBL remain legitimate short term policy tools, they actually exacerbate the problem.

### SLT: If restricting SBL is not a viable long term tool of regulators what do you think they should do?

**Postlethwaite:** I believe that most financial regulators have a good grasp of the key issues affecting the markets, central among which are the questions of credit and systemic risk. I welcome the increased focus (as seen in the recent BIS discussion paper) on ensuring that risk capital is sufficient to ensure that banks can actually survive a crisis as going concerns, not merely have enough to pay creditors in an insolvency situation. The proposed changes to Basel II and to CRD in the EU are clearly directed at increasing the capital required to cover risk positions and improving the quality of capital. Both of these seem to be sensible and proportionate proposals.

### SLT: But in the SBL arena where most stock is lent by entities, which are not Basel II regulated, does an increase in Basel II capital requirements actually have any effect?

**Postlethwaite:** This is a crucial point. Institutional lenders have taken a view that their loans are 100 per cent guaranteed by their lending agent banks. So where is the risk? If it is with the agent then the bank's capital should be applied, if the risk is with the lender then they should accept it. We seem to have ended up in a situation where if a bank lends stock the transaction is seen as risky and requires risk weighting and capital, but if a beneficial owner lends stock guaranteed by the bank the risk is somehow mitigated.

### SLT: Doesn't the collateral pledged by borrowers cover risk?

**Postlethwaite:** In all normal circumstances, yes. However it does not eliminate risk completely if you are a Basel II regulated company. Collateral will be a main focus if the current set of recommendations on minimum haircuts is adopted. If these proposals are incorporated into Basel II and CRD we might be look at 15 per cent and 25 per cent haircuts on equity collateral. This in turn creates a problem for borrowers who have a large exposure to lender default, which they must cover with capital.

### SLT: Isn't all this a bit theoretical? The record of regulators in implementing anything new is one of very slow progress. Basel II took years to implement; surely it will be several years before we see Basel III?

**Postlethwaite:** The issue with Basel II was that for many banks it had the potential to reduce overall capital requirements from Basel I levels. As such regulators and central banks were very cautious in its implementation, especially in the USA. The so-called Basel III changes will have the opposite effect; they are likely to increase the requirement for capital (especially the common stock element) and so are likely to be welcomed by national regulators in the current climate. I expect that we will see agreed policy before the end of this year, to be implemented in 2011.

### SLT: You paint a picture of major challenges facing the SBL industry, with increased regulation and increased costs; how can you square this with your view that the industry is likely to grow?

**Postlethwaite:** The re-assessment of the industry in the wake of the banking crisis has, in my opinion, strengthened our industry. Agent lenders are improving their risk management services and their contracts; tri-party providers are looking increasingly attractive, and there are many more inventive and flexible ways to collateralise positions than before. The industry as a whole is responding well. The CCP initiative of SecFinex is just one element of this response.

### SLT: How do CCPs fit into the picture?

**Postlethwaite:** CCP structures have always been attractive as a way of controlling risk. Following the banking crisis regulators have been keen to promote them, and the proposed changes to Basel II are specifically aimed at moving many OTC products into CCP structures. Remember CCPs are zero weighted for risk purposes and so offer a major advantage, especially in a world where risk will be weighted higher and more capital required. In the past, the problem with applying CCPs to SBL has been the complexity – something which we at SecFinex have spent two years overcoming. The legal, tax and risk hurdles have been formidable but we are now able to offer the market a CCP based service which will reduce their capital exposure and reduce their risk. For firms concerned with capital costs, credit risk and a dwindling pool of eligible borrowers, the SecFinex CCP structure offers an attractive alternative. **SLT**

# Industry change

## Katharine Gill Law examines the issues surrounding regulation, both from the authorities and within the capital markets industry, and highlights the key questions the industry needs to consider.

**SLT** EXCLUSIVE

These are confusing times for capital markets participants. Just as developed economies began showing signs of recovery in the latter half of 2009, new and material signs of trouble in Greece and elsewhere have had a contagious impact on global markets, stifling growth and potentially reversing the nascent econ omic recovery. The myriad financial reform proposals on the table are only adding to the confusion.

The global securities lending industry is not immune from the tumult, nor are the beneficial owners, agents and borrowers who participate in the market. At the depth of the financial crisis, short selling was vilified as the handiwork of unscrupulous short sellers working in a concerted fashion to depress share prices – an interpretation of events that, rightly or wrongly, dragged securities lending squarely into the spotlight. In the short time since, media coverage of the securities lending industry has continued to increase, while the market itself has slowly recovered lost ground. As Bernstein Research recently concluded, "the cyclical decline in securities lending seems largely played out." Bernstein predicts six per cent volume growth for US securities lending in 2010, followed by 18 per cent growth in 2011.

Even as the industry recovers, the inevitable implementation of broader financial industry reforms could profoundly impact the structure of the market. With investor protection as a chief goal and responsibility of this SEC administration, the growing size, scale and impact of securities lending as it relates to both the public shareholder and issuer companies has made the industry a new regulatory focus. In a September 2009 speech, chairman Mary Schapiro said the SEC is conducting a "wholesale review" of the securities lending market and looking at everything from potential conflicts to transparency issues.

Similar points have been expressed by the Financial Industry Regulatory Authority (FINRA), the Federal Reserve, the Bank of International Settlements (BIS) and various other regulators and agencies. The aggregate impact of these reform efforts could result in some formal action to deliver increased market transparency to public investors, as well as change the nature, scale and costs associated with affiliate-based lending relationships.

The SEC's focus on protecting the public investor underscores a growing recognition that fundamental market principles – transparency, risk mitigation and access chief among them – should be proactively embraced by securities lending participants if the industry is to truly serve the needs of the investing public.

The question for our industry is: how do we achieve these objectives in a way that preserves a vibrant, service-oriented commercial model while embracing a policy direction that challenges the fundamental practices upon which the securities lending industry was constructed? It is in our industry's best interest to embrace time-tested, market-based reforms to forestall the possibility of a more aggressive regulatory response down the road.

The industry has widely debated the need for structural improvements over the last two years – a debate that seems to have crystallised around the fact that, while securities lending losses were real, those losses could be clearly attributed to the management of cash collateral and not counterparty defaults.

Others argue that they simply do not see the fundamental value of alternative market structures, and therefore have not been motivated to depart from the status quo.

The first is an acknowledgement that, as the industry resumes growth, new market structure alternatives will continue to emerge

Missing from some of this analysis, perhaps, is the fact that market dislocations tend not only to attract outside scrutiny, but also to more subtly change the behaviors of market participants themselves. A renewed focus on intrinsic value lending, reduced overall leverage in the system, strict delivery requirements and the need for more efficient use of dealer capital are only a handful of reasons that behaviors have changed over the last two years. In any case, the financial crisis reminded market participants and regulators that securities lending is no longer a "back office function" with *de minimis* implications to the broader capital markets and the public investor. These factors are accelerating the movement towards structural reform, including:

- The importance of responding to the global call for increased regulation, market transparency and the centralisation of credit;
- A deeper awareness of the risk-adjusted return on securities lending for beneficial owners;
- Increasing focus on counterparty risk by lenders, borrowers and intermediaries.

On an international level, recognition of these factors has already compelled action. The Bank of International Settlements' Committee on the Global Financial System has addressed what it termed, "the stress on the financial system caused by 'procyclical' margin practices." In doing so, BIS acknowledged that during times of stress, individual firms would respond rationally to their own circumstances and those of their counterparties, but would do so without consideration of the larger systemic impact. "In essence," the report noted, "these collective actions of what is reasonable behavior at the individual institution level allow for the materialisation of bad outcomes for the financial system as a whole."

## Market structure alternatives

As readers of *Securities Lending Times* are well aware, structural alternatives are emerging that address both the causes and effects of the changes now occurring in financial markets. At the forefront is a simple, well-proven solution – automating the stock lending process by bringing lenders and borrowers together in a regulated, electronic trading market backed by a strong central counterparty ("CCP").

The elements of the exchange-based CCP model are instantly recognisable as attributes of any developed market:

- Reduced systemic risk
- Increased transparency
- Reduced trading costs through increased efficiency
- Reduced fails to deliver
- Increased liquidity

## Unintended benefits vs. unintended consequences

There is much talk about the unintended (and typically negative) consequences of change. Predictable as these concerns may be, more often than not they are borne from instinctive dismissal of an unexamined opportunity. Markets require the symbiotic interaction of buyers and sellers, both principals and agents, inclusive of institutional and retail clients, in order to arrive at the best possible market methodology. Oftentimes these symbiotic relationships emerge from coincidence rather than design. The introduction of an exchange-based CCP market for securities lending exemplifies this market effect for many reasons:

- Electronic, direct market access facilitates the shared needs of wholesale lenders and retail borrowers; including the dynamics of supply and demand as well as their common requirements and desires as fiduciaries
- Dealer-sponsored access to a central market allows the brokerage community to remain in control of both the fair market cost of providing market access as well as their institutional risk management processes
- CCP-based clearing creates important capital, margin, balance sheet funding and risk-based efficiencies for the dealer community, in part as a result of their having provided market access to underlying clients
- In aggregate, the downstream effects of these improvements impact the underlying fixed-cost structure of the broker-dealer clearance process, again creating efficiencies from which both dealers and their clients stand to benefit
- Integrated technology platforms that automate market access, trade matching, clearance, settlement, open loan maintenance, and accounting and billing processes create cost synergies that benefit dealers and clients alike.

## The road ahead

Securities lending is a complex market with diverse stakeholders, which makes any departure from the traditional model difficult to implement. Going forward, two key drivers underlie efforts to modernise the market. The first is an acknowledgement that, as the industry resumes growth, new market structure alternatives will continue to emerge. These alternate routes to market will only be successful if they are designed to work alongside existing business practices and supplement the growth of the industry as a whole. The second is that regulatory issues, the importance of capital efficiency, increasing 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.

Embracing the appropriate elements of this change will allow the market to strengthen itself, bring the industry in line with other regulated components of the capital markets, and restore confidence for the investing public. **SLT**

Katharine Gill Law is chief marketing officer at Automated Equity Finance Markets, a Quadriserv Company

# Collateral Damage

## What is an acceptable risk adjusted return in turbulent markets, asks John Arnesen, senior business consultant at Data Explorers

**ANALYSIS**

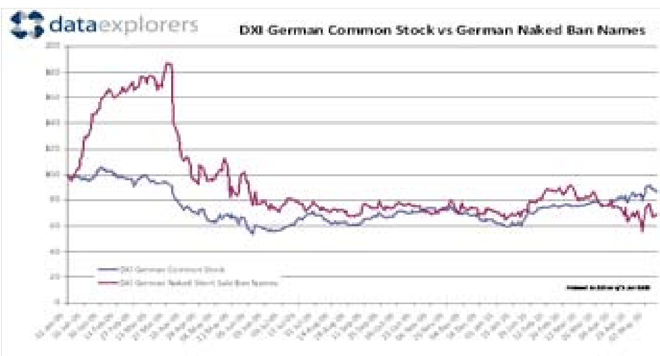
The recent announcement of a €750 billion facility provided by the International Monetary Fund, European Central Bank and European Governments was meant to stop the speculation regarding the indebtedness of European nations.

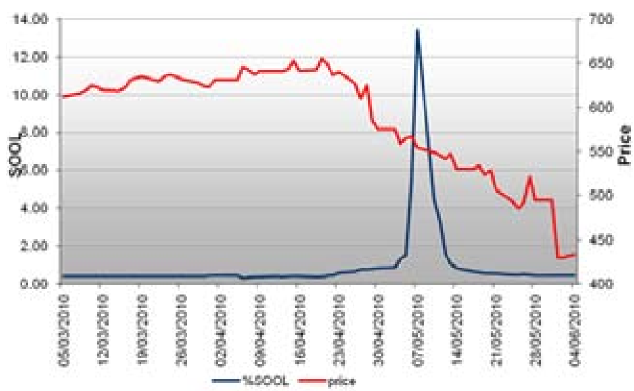
While focus remains on the "PIIGS" nations of Portugal, Ireland, Italy, Greece and Spain some are questioning the whole viability of the Euro currency. The ensuing political ramifications seem to have pushed the German regulator to act unilaterally by announcing a ban on naked short selling of 10 financial stocks and Eurozone Government securities. This was closely followed by onerous disclosure requirements about short positions in Spain. Against this, the European Union ratified the Alternative Investment Fund Managers (AIFM) Directive that will provide tighter regulation on hedge funds, despite UK opposition.

Looking at the ban on naked short selling in Germany, research by Data Explorers suggests that the 10 equities involved were not being widely shorted and in fact, short interest has declined in those names over the last few months, despite a rise being noted in a basket of German large caps (see charts). Out of the ten names that are subject to the naked short selling ban, most have low short interest (less than two per cent shares outstanding on loan), while only Commerzbank has seen relatively high levels of short interest (around six per cent) over the past year and a half.

Commentators complain that markets are not behaving in a rational fashion, yet participants are aware that this period of irrationality can last longer than they can remain solvent. Despite estimates that computer generated flash trading accounts for 70 per cent of market volume, some regulators for the last two years would have us believe short selling is at fault; that the practice of short selling moves stocks in a certain direction and that short selling is inextricably linked to deteriorating price action. BP is an interesting case. The company has lost over a quarter of its value since the accident in April. Stripping out the dividend payment in May, our chart below shows that no increase in short selling has accompanied that decline. In this case, one could argue that it is the short sellers who have focused on company's fundamentals more than a single opportunistic event.

With a feeling of déjà vu, let's consider the outlook for our industry. Against a backdrop of reduced supply from beneficial owners and a heightened focus on risk management, participants at the recent Data Explorers Securities Financing Forum in New York still expressed a keen desire to explore alternative structures, with over 40 per cent of attendees expressing a desire to take more risk to retain or increase revenues. In these difficult markets, the quest for increased efficiency and higher risk-adjusted returns is driving all participants to consider whether now is the time to change their business models. **SLT**



## The 19th Annual International Securities Lending Conference

Date: 22-24 June 2010
Location: Berlin, Germany
Website: www.afme.eu/isla2010

ISLA's International Securities Lending Conference will be held from 22 to 24 June 2010 in Berlin. Now in its 19th year, this is the only event of its kind in Europe attracting in excess of 400 senior market participants from banks, broker dealers, asset managers, pension funds, hedge funds and policy makers.

## IMN's 2nd Annual East Coast Beneficial Owners' Securities Lending Summit

Date: 28-29 June 2010
Location: Boston, MA
Website: www.imn.org/seclending2010_slt

In February 2010, IMN`s Sixteen Annual Beneficial Owners' Securities Lending Summit attracted over 115 Beneficial Owners to North San Diego, California, where they candidly discussed the profound effect that global events have had on their Securities Lending programs.

## IMN's 15th Anniversary European Securities Lending Summit

Date: 20-21 September 2010
Location: London
Website: www.imn.org

In September 2009, more than 250 attendees and 60 Beneficial Owners participated in IMN's 14th Annual Beneficial Owner Securities Lending Summit. Leading European decision-makers discussed important issues confronting Beneficial Owners and the Securities Lending industry at large.

## 27th Annual RMA Conference on Securities Lending

Date: 12-14 October 2010
Location: Boca Raton Resort & Spa in Boca Raton, Florida
Website: www.rmahq.org

The Boca Raton Resort has always been one of our premier conference locations. It was the site of the very first RMA Conference and continues to be the foremost favorite venue. We know you'll enjoy the newly renovated Boca Beach Club. It is quite a dramatic transformation!

If you would like your event featured here and on our website
contact: news@securitieslendingtimes.com

# Industry Appointments

Macquarie Securities Group, the institutional equities arm of Macquarie Group has announced the appointment of **Richard Sansaricq** as head of Delta One & synthetic prime brokerage sales, a newly created position.

Sansaricq will be responsible for sales of Macquarie's delta one and synthetic prime brokerage activities globally. Based in New York, he will lead a team of nine salespeople located in New York, London, Hong Kong and Sydney. Sansaricq was mostly recently head of algorithmic sales at Fox River Execution and immediately prior to that was co-head of global prime brokerage and algorithmic sales at BNP Paribas. He has also held senior positions at Abbey National, Credit Suisse and Lehman Brothers among other firms. With deep industry knowledge gained over 20 years, his experience spans delta one products including traditional and synthetic prime brokerage, equity finance and equity execution.

Sansaricq will report jointly to Greg McCafferty, Head of Delta One & Synthetic Prime Brokerage globally for Macquarie Securities, and Todd Steinberg, global head of derivatives delta one.

Commenting on the appointment, Mr. Steinberg said: "Rich brings a tremendous amount of experience and industry contacts in the delta one/synthetic prime brokerage space. Rich's knowledge and skill-set will be integral to the continued build out of Macquarie's global equity finance capability."

J.P. Morgan Asia Pacific has appointed **Thomas DuCharme** as chief executive officer of the firm's Treasury and Securities Services (TSS) business in Asia Pacific.

DuCharme will lead the expansion of all parts of the TSS business in the region and be a key partner in the accelerated growth of the firm's Global Corporate Bank.

Heidi Miller, global chief executive officer of TSS, said: "I'm thrilled to welcome Thomas to the team. His hire is an important step for our business as we continue to build and expand the franchise across the region."

DuCharme joins J.P. Morgan from Deutsche Bank where he was head of transaction banking, Asia Pacific. Prior to this, he spent 15 years at Citigroup, also in transaction banking.

Gaby Abdelnour, chairman and chief executive officer of J.P. Morgan Asia Pacific, said he was delighted that DuCharme was joining J.P. Morgan. "We see immense scope for growth within our TSS franchise and Thomas's strong experience in transaction banking across Asia Pacific will allow us to achieve this potential," he said.
DuCharme will report to Abdelnour and Miller. He will also be a member of the TSS Global Executive Committee and the J.P. Morgan Asia Pacific Executive Committee.

**Shawn Wischmeier** will join the Department of State Treasurer as the new chief investment officer for the $68 billion North Carolina Retirement Systems.

Wischmeier comes to North Carolina after serving as chief investment officer for the Indiana Public Employees' Retirement Fund (PERF) since 2006 where he brought the plan from fourth to first quartile investment performance in less than four years and was recently recognised as Large Public Plan of the Year by Institutional Investor News' Money Management Letter. Prior to joining PERF, Wischmeier was with Eli Lilly and Company's Global Treasury group, where he progressed through varied roles, primarily focused on pension and benefit investments, corporate investments, and financial risk management.

eSecLending has announced that **Matthew Bray** has joined the firm in their US office as senior vice president of securities financing and asset/liability management.

Bray joins from AllianceBernstein where he was a vice president and trading manager of the Securities Financing Desk, managing the investment firm's equity and fixed income lending and borrowing activities. Prior to AllianceBernstein, Bray was the head USD repo & securities finance trader at Brevan Howard Asset Management and held various senior trading positions at Man Securities Inc, Tokyo-Mitsubishi Securities and the Bank of New York throughout his career.

"We are excited that Matt has joined our growing trading team and are confident he will deliver immediate value to our clients' securities lending programs," said Chris Poikonen, global head of securities financing at eSecLending. "We are committed to expanding the breadth and depth of our distribution network and we are certain that Matt's extensive trading and market experience will help further this progression."

"I am pleased to have joined eSecLending," stated Bray. "Their differentiated model is well positioned in the current market environment and I look forward to contributing to the continued success of the firm."

Northern Trust Global Investments (NTGI) Limited, has, as a result of increased demand for securities lending products and services, enhanced its securities lending team with the appointment of Mark Snowdon as senior sales and relationship manager and Mark Jones as a product manager.

In the newly created position of senior sales and relationship manager, Snowdon will expand and develop Northern Trust's securities lending client relationships across the Europe, Middle East and Africa (EMEA) region. Snowdon joined Northern Trust from JP Morgan where he was head of business growth EMEA global custody.

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With over 20 years' experience in financial services, he is also an Associate of the IFS School of Finance.

As securities lending product manager, Jones is responsible for developing new products and solutions to meet and anticipate the changing needs of Northern Trust's securities lending clients. Jones joins from JP Morgan where he performed a similar role.

"We are seeing renewed interest in securities lending among many of our clients," said Andy Clayton, global head of securities lending at Northern Trust. "Clients are attracted to our conservative approach to risk management and consequently we have expanded our London based team with these two new appointments. The experience they bring to these roles will ensure we continue to deliver first-class services to our clients as our global securities lending business continues to grow."

Send your latest recruits to editor@securitieslendingtimes.com

# 60 Second Resumé

## Michael Mooney

**Meet Michael Mooney from Massachusetts, an experienced and knowledgeable professional, who has succeeded in a number of trading roles at many of the major banks**

### Contact Michael

People can contact me directly by accessing my LinkedIn profile at www.linkedin.com/in/michaelmooney

### Tell me a little about yourself

I began my career in the custody world in 1995 following my graduation from an accelerated five-year MBA Program at Clark University in Worcester, Massachusetts.

I quickly moved up from a role in fund accounting to the securities lending trading desk at Investors Bank and Trust in 1997. When IBT was purchased, a moved to a senior trader role on the domestic equity desk at Brown Brothers Harriman. My tenure at BBH was spent on both the domestic equity and Far East books - I networked into this role by always asking questions of members of the securities lending group and monopolising their shared Bloomberg Terminal. I have always had an interest in the markets.

I have been married to Ruth for seven years and have one daughter, Ariel. We live in Brookline, Massachusetts, but are open to moving to new locales.

### What industry qualifications or relevant certification do you hold?

I am knowledgeable with regard to dividend arbitrage and event driven trading as well as the way the modern securities lending trader operates. Stock loan has developed itself from the "how ya doin" mentality to being a more sophisticated and thoughtful front office function. No certification is held as it was not required or offered as an option for either of my prior employers. I am very open to certification in the future

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

I have had varied roles as a senior trader on desks at both Investors Bank and Trust and most recently Brown Brothers Harriman. I have always enjoyed the fast pace of trading, the strong relationships that are developed internally and externally, the creation of thoughtful market commentary for beneficial owners, and the opportunity to develop myself. I worked with great teams and management in both of my prior roles. My hat goes off to them all.

### What area are you looking to get back into?

Ideally, I would like to join a desk in Boston as a senior member of a domestic equity team. The Boston market however, has compressed significantly in the last two years and I have realised that to continue as an industry member in Boston, I will have to reinvent myself. That said, I am looking at trading roles nationally as well as programme management roles for beneficial owners and securities lending oversight roles at hedge funds.

### What do you feel the industry needs most?

Certainty. There continues to be uncertainty with regard to regulation in the hedge fund space as well as rest of the securities lending arena. Many beneficial owners continue to be hesitant with their re-entry to securities lending programs until future regulation and certainty come to fruition. In addition, we all hope for increased reinvestment levels in the near future with true risk mitigation. These increased levels will help maintain and hopefully increase income for all involved parties as beneficial owners re-initiate their programs and potentially saturate the market with securities.

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

I will bring fresh energy, long-term relationships, knowledge and ideas gleaned from almost 15 years in the industry. I am a shrewd negotiator and know how to create the balance necessary to have borrowers work to maximise levels on new loans to adjust open borrows to market levels in an efficient and equitable way for all parties involved. **SLT**