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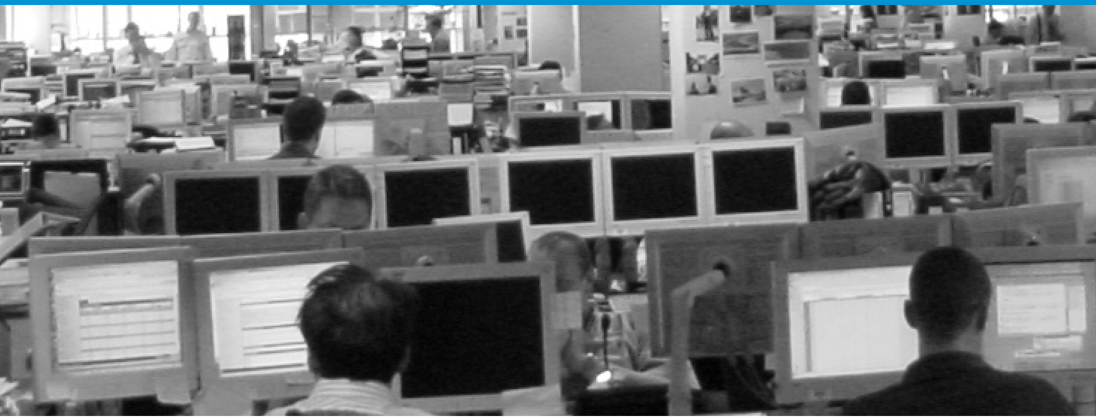

Southwest fined over failures

DALLAS 25.03.2011

The US Financial Industry Regulatory Authority (FINRA) has fined Southwest Securities $650,000 for deficiencies in due diligence, risk assessment and written supervisory procedures that permitted one of its correspondent firms, Cutler Securities, to create risk for Southwest through improper short sales.

FINRA also required Southwest to designate a risk management officer to identify and manage the risks associated with its correspondent clearing services business. In addition, FINRA expelled Cutler Securities and barred its president, Glenn Cutler, for Cutler Securities' violative short selling.

On August 6, 2009, its second day of clearing through Southwest, Cutler Securities bought over 17.8 million shares of a stock while selling over 20.3 million shares of the same stock. Despite receiving alerts regarding this trading during the day, Southwest allowed Cutler to establish a 2.5 million share short position. Cutler Securities was unable to meet its obligation on the position, requiring Southwest to close the position, leaving it with an unsecured debit balance of approximately $6.3 million.

Brad Bennett, FINRA executive vice president and chief of enforcement, said: "Southwest's systemic failures in overseeing its clearing services led to considerable financial losses for itself, and illustrates the risks that can be created by correspondent firms. Southwest's failure to effectively monitor Cutler's reckless behavior jeopardised its ability to meet its obligations to its other correspondent firms and counterparties."

Among the deficiencies in Southwest's supervisory practices were failures to establish written due diligence policies, written criteria to determine the acceptability of potential correspondents, awareness of the proper procedure for terminating correspondent firms on an intraday basis, appropriate trading alert parameters for many of its correspondent firms, and procedures recognising that it had clearing and settlement responsibility for all correspondent firms that had the ability to execute trades away from Southwest.

NEWSINBRIEF

Sweden warns on short selling ban

The head of Sweden's National Debt Office has sounded a note of caution on the EU's proposals to ban naked short selling.

Bo Lundgren said the plans could cause problems for smaller countries who need to fund their national debts, and called on the EU to reconsider its approach.

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PrinceRidge Group selects QTIX

The PrinceRidge Group has selected ReadQ Systems' QTIX trading system for its start-up financing desk.

"QTIX, our latest technology offering, is designed to provide broker-dealers with a robust yet user friendly solution that is easy to implement. We look forward to working with The PrinceRidge Group to help grow their new business initiative."

The PrinceRidge Group launched its institutional finance desk, headed by Thomas McHugh in December 2010. The financing desk offers a full range of repo & securities lending in most USD fixed-income assets and specialises in a variety of financing solutions to assist its clients by boosting returns on cash and securities holdings, financing long positions, matching cash flows and reducing funding costs.

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Sweden warns on short selling ban

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"Too often - I know as I was once a politician - politicians are a bit shortsighted and don't take analysis to heart," Lundgren told Bloomberg.

Sweden is just one of several countries that have expressed concern about proposed plans. Many countries have warned that any changes could have negative consequences for the markets.

PrinceRidge Group selects QTIX

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According to Robert Cardone, president of ReadQ Systems, "QTIX, our latest technology offering, is designed to provide broker-dealers with a robust yet user friendly solution that is easy to implement. We look forward to working with The PrinceRidge Group to help grow their new business initiative."

Registrations now open for ICMA/ISLA workshops

The International Capital Market Association (ICMA) and the International Securities Lending Association (ISLA) will be holding a workshop on the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA).

These two separate master agreements are the essential legal underpinnings for the repo and securities lending markets respectively. The three-day workshop will include a detailed review of both legal agreements and their application. The workshop will also include coverage of the soon to be published GMRA 2011. In addition to case studies, the operational and basic legal characteristics of the repo and securities lending markets will also be discussed.

The workshop will be delivered by Richard Comotto, the author of ICMA's Repo Survey, together with legal and documentation professionals and representatives from ICMA, ISLA and Freshfields.

The Global Master Agreements for Repo and Securities Lending Workshop is an accredited course under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 18 hours CPD credit for their attendance on the whole course.

The workshop will be held in London from 18-20 April.

Paladyne to expand in Asia as growth continues

Paladyne Systems has announced expansion plans in Hong Kong as demand grows for its FastStart software.

Since Paladyne FastStart was introduced in Asia-Pacific 15 clients have signed-up for the offering. Firms implemented include Paridon Asia, Instinct Capital, and Gen2 Partners.

"After our due diligence process we found Paladyne FastStart to be the solution for us that was capable of handling the complexity of our strategies, as well as, the growth we anticipate in the coming months," explained Robert van Paridon, CEO of Paridon Asia, a Singapore-based Asian macro hedge fund.

"We are delighted that Paladyne FastStart has resonated so profoundly as an industry standard solution for fund managers in the Asia-Pacific region," said Sameer Shalaby, CEO of Paladyne "We have recently hired five new employees and have plans to continue our aggressive expansion with the addition of a further 10 employees to our Hong Kong office in 2011."

Ratio of longs to shorts at a six year high

New research from Data Explorers shows that the ratio of longs to shorts has hit a six year high.

Data Explorers clients can now access six years of data history, helping them make better informed decisions when analysing both the supply and demand behind short selling activity.

The data is global, timely and updated daily at a regional, sector and individual stock level. Applying the six year back history analysis to the Data Explorers LongShort Ratio for All Equities reveals:

- The global equities ratio of longs to shorts stands just off a six year high at 9.3. There are nine times more longs in the market than shorts.

- This has been driven by an increase in the value of global equities made available to be borrowed by long Only funds who lend. Today this stands at USD 7.5 trillion.

- The value of stock on loan is well down on the highs seen in the run up to the credit crunch. However, it has been gently rising over the last year to USD 810 billion.

Clients using the Data Explorers Excel Toolkit can now access six years data history.

New lending reporting solution from Northern Trust

Northern Trust has created a report to assist insurance companies with regulatory filings on securities lending programmes. The "Schedule DL" report provides Northern Trust asset servicing clients with information formatted to fulfill National Association of Insurance Commissioners (NAIC) reporting requirements for securities lending reinvestment collateral detail.

"Insurance companies that participate in lending programmes as a way to enhance returns on investment portfolios face new regulatory burdens intended to manage risks and enhance transparency," said Sheldon Woldt, head of the Insurance Client segment of Northern Trust's asset servicing business. "As custodian and securities lending agent, we are positioned to help our insurance clients fulfill reporting requirements with automated solutions. The new 'Schedule DL' report demonstrates Northern Trust's commitment to assisting insurers meet the challenges of changing regulatory requirements."

Northern Trust

For your securities lending business, rely on Northern Trust's unique global integration, exceptional capital strength and time-tested risk management. To find out more, visit northerntrust.com/securitieslending or call Chris Doell at +1 312 444 7177 or Sunil Daswani at +44 (0)20 7982 3850.

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Schedule DL, effective December 31, 2010, requires insurance companies to show detailed holdings of reinvested collateral on securities loans. The detail required by the rule is not typically available in insurance investment accounting systems. Northern Trust's solution combines information from its securities lending database with its insurance investment accounting capabilities to assign Schedule D classifications and NAIC ratings received from the Securities Valuation Office (SVO). The data is presented in a format that is compatible with the NAIC formatted file requirements.

"Without the Schedule DL from Northern Trust, we would need to manually collect collateral reinvestment detail and present it in the statutory annual and quarterly statements in the NAIC required format," said Randy Johnson, senior vice president-investments, Texas Mutual Insurance Company. "Northern Trust provides a report that saves us time and makes it easier for us to meet our regulatory reporting requirements."

DX: 'Markets cannot function without short selling'

Will Duff Gordon hosted a panel of three short selling academics at the Data Explorers London Securities Financing Forum.

Each academic made their case for short selling by providing a summary of their key findings in their individual.

Dr. Alessandro Beber, Amsterdam Business School, compared the performance of markets in countries that impose a short selling ban and those that do not. The costs and benefits of short selling and the effects to single stocks were weighed up. A key finding was the fact that banning short selling has a detrimental effect on liquidity. It was found that the negative effect on liquidity is at approximately 25 per cent in countries with a ban. Liquidity problems are seen to be further amplified in small, volatile or non-option stocks.

Ekkehar Boehmer, EDHEC Business School, used the daily shorting flow in the US markets to carry out the research. Findings showed that short selling accounts for a large proportion of trading activity, 28 per cent in 2008. Dr. Pedro Saffi led with "Don't shoot the short selling messenger"!

Senate to give new guidelines on securities lending

Two US government committee reports have published new guidelines on how securities lending should be explained and practiced in 401(k) plans.

The Senate Special Committee on Aging and Government Accountability Office have each conducted investigations into securities lending and how it affects plan sponsors and investors in employer retirement schemes.

One of the main recommendations is expected to be that employers should provide plan participants with clearer information about the benefits and risks of securities lending in their plan options.

The Senate Aging Committee will also ask the US Labor Department to develop tools and guidance for employers on the benefits and risks of securities lending, and recommend that companies in the business of securities lending report information on their practices to the SEC and bank regulators.

Options Clearing Corporation rebrands

The Options Clearing Corporation has revised its brand identity and will now be known as OCC in a move that it says reflects its more diverse suite of clearing solutions.

It has, of course, been informally known as OCC for 35 years, so the change - along with the slightly revised logo - more closely represents the evolution taking place at OCC, and in the marketplaces it serves. Clearing US exchange-listed options remains the core business, but OCC offers more clearing solutions than the name Options Clearing Corporation implies.

Today OCC provides central counterparty (CCP) clearing and settlement services to 15 exchanges and trading platforms for options, financial and commodity futures, security futures and securities lending transactions. As a customer-focused clearing organisation, OCC works to ensure its services offer the greatest utility to participant exchanges and clearing members at the lowest possible cost and at the highest risk management standard.

"OCC was formed as the CBOE Clearing Corporation and became the Options Clearing Corporation as more exchanges began trading options and the marketplace changed. Today we are recognising again how our role in the market is changing," Wayne P. Luthringshausen, OCC chairman and CEO. "What is not changing is OCC's role in providing a foundation for secure markets."

Capco to develop hedge fund and prime services offering

Capco has appointed Gary Goldberg as a director in the company's UK Capital Markets team. Goldberg will focus on growing Capco's presence in the hedge funds and prime services segments of this market.

"The alternative investments sector is growing rapidly and undergoing extraordinary change," said Goldberg. "I am excited to be working with Capco to develop solutions that cater to the specific needs of hedge funds and prime brokerage firms. We have a great opportunity to build on Capco's deep industry expertise in what we firmly believe is a very attractive market.

"The industry is going through several fundamental shifts. On the one hand, investors are flocking to size, which is leading to industry consolidation; at the same time regulatory changes have resulted in a large number of new fund launches. Capco's deep domain knowledge and thought leadership skills position us strongly to support the needs for fund launches, regulatory requirements, cost-saving and integration programmes."

Jonathan Davis, Capco partner, added: "We are delighted that Gary has joined Capco's UK Capital Markets team. Capco is a fast-growing

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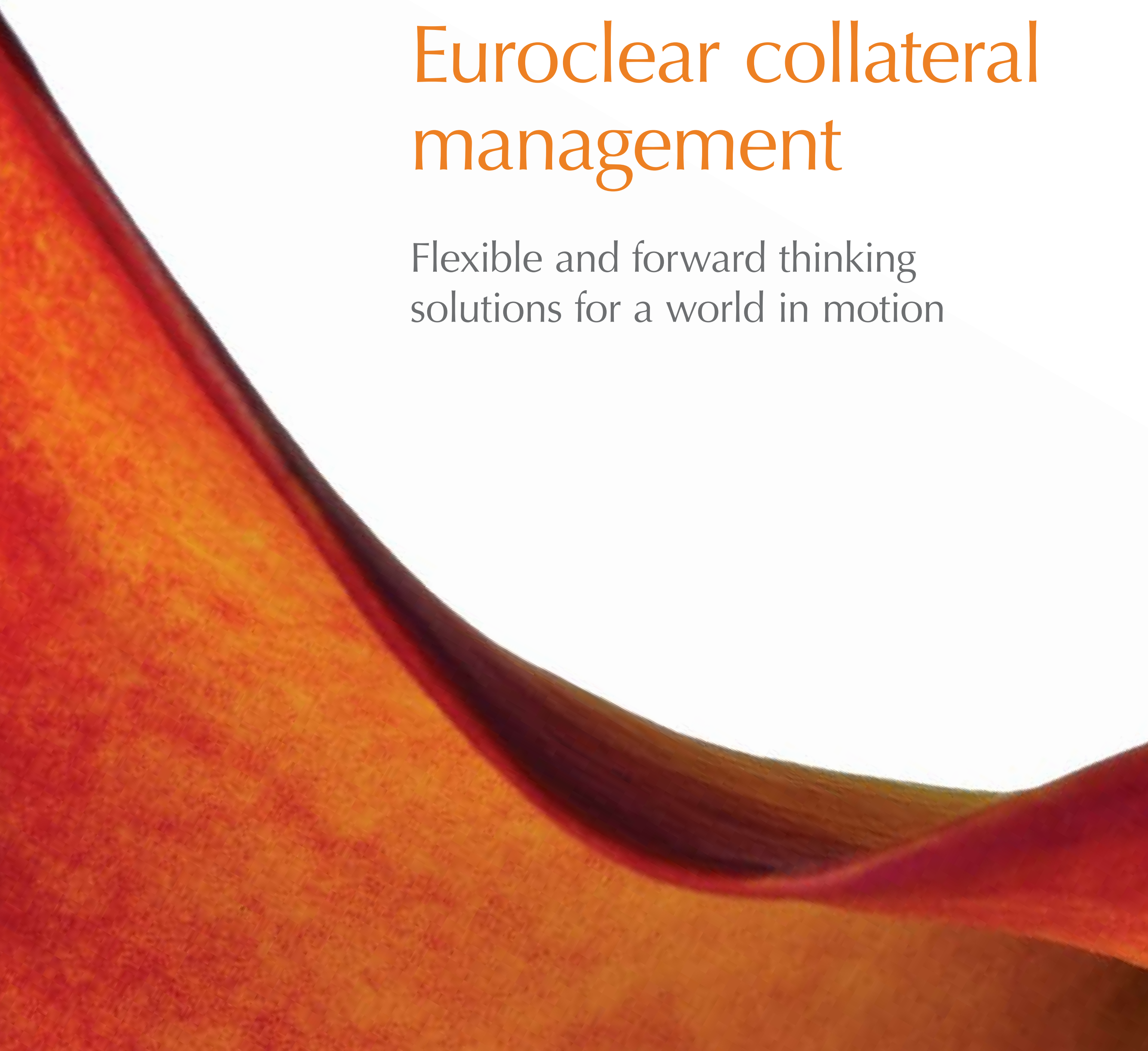

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business and we believe significant growth opportunities exist within the hedge fund and prime services sector. Gary's deep experience and understanding of this area of financial services will be invaluable in defining and expanding Capco's offering in this space."

Goldberg joins Capco with significant expertise in the financial services industry having held a number of senior positions in the capital markets industry over the past 16 years. Most recently, Goldberg worked as global head of front office technology for BlueCrest Capital. In this role he was responsible for front office technology strategy development, strategic risk architecture delivery and overseeing teams dedicated to the global trading desks. Gary also launched and oversaw the firm's STP and static data architectures, and managed the technology change programme for three multi-billion dollar fund migrations.

Nomura quitting prime brokerage?

Nomura is scaling back its London prime brokerage team, with some insiders suggesting the bank will be withdrawing from the international market altogether.

Nomura, which cut back its commodities desks earlier in March, said its changes are relatively small, with redundancies in single digits.

At the end of 2010, Nomura's global head of prime services Tim Wannenmacher resigned from the bank. It has just been announced that Matthew Pinnock, co-head of prime services EMEA and global head of prime sales and capital introductions has also moved on.

It has long been expected that Nomura would scale down its operations following its acquisition of parts of Lehman Brothers, and the current unfolding tragedy in Japan may also lead some global Japanese firms to rethink their international aspirations.

Securities lending goes live in Pakistan

The three Pakistani stock exchanges have introduced a securities lending system.

Muhammad Lukman, chief executive officer of the National Clearing Company of Pakistan said the margin trading system (MTS) and margin financing system (MFS) were introduced on March 14.

"NCCPL acting as an authorised intermediary shall provide an automated portal to leveraged market participants to access markets through interface made available electronically," explained Lukman.

"In the past, participants have often complained that the prices of certain equities are unreasonably inflated by one or more influential groups," said Lukman. "If participants feel that the price of any stock has surged, they can use SLB to short sell in that item," he added.

Borrowers will be able to borrow equities for a period of up to 22 days, at a rate to be determined by demand and supply. However, the rate will be around Kibor plus eight per cent.

"In the event that there is any sort of corporate action or payouts are announced by the company, those shares will be forced release to the original owner prior to the maturity of the contract under SLB," he explained.

Cash margin will be collected from the borrower at 25 per cent or value at risk (VaR), whichever is higher, while daily mark-to-market losses will be collected and directly distributed to the lender under SLB.

dR Russia Desk launches new Russia and CIS service

dealReporter has launched its new Russia and CIS intelligence service, the Russia Desk.

The Russian government's drive to integrate the country further into international capital markets and a healthy pipeline of new listings from the private sector are creating stronger demand for reliable intelligence from the region.

"The aim is to leverage our existing pool of industry sources around the world and locally to help money manager better understand unsystematic risk in the region. The only way to achieve this is to have a local view in the context of a global market," said dealReporter global editor-in-chief Yanita Morris.

The Russia Desk will offer exclusive and detailed reporting and analysis of top stocks in Russia, as well as Ukraine and Kazakhstan. With a dedicated team of journalists on the ground in Moscow, Kiev and Astana, as well as correspondents throughout Asia, Europe and the US, the Russia Desk will combine dedicated reporting in the local market, with a solid international perspective.

The new service will leverage dealReporter's global expertise in pre-empting and analysing major corporate events, such as M&A and capital markets transactions.

As part of its unique offering, the Russia desk will interview key figures in the worlds of business and politics, specifically focusing on the country's changing corporate governance and policies.

Using its global access to buy side investors, the Russia Desk will keep tabs on daily trading trends in key regional exchanges and provide commentary on who, how and what is moving the market.

In addition to proprietary news coverage, readers will get an access to an experienced team of in-house analysts producing cutting-edge research on companies in the Russia Desk universe.

"The pace of integration into international capital markets by Russia, Ukraine and Kazakhstan has created an urgent demand for quality information from those countries," said CIS bureau chief, Rob Hartley.

"The Russia Desk aims to give expert insight to financial markets players with an interest in CIS equities," Hartley added.

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Israel

Securities lending has been a relatively closed shop in Israel. But the tide is turning

BEN WILKIE REPORTS

Although some investors take political considerations in mind when looking whether to operate in Israel, the market has done surprisingly well over the past few years.

It's one of the few countries to have survived the credit crisis relatively unscathed - Israeli investors are comparatively conservative and didn't invest in the riskier markets that have brought down their international counterparts.

"Israel is one of the strongest markets in the world, and has recently become an OECD member as well as being part of the MSCI developed world indices and has hardly been affected at all by the credit crisis," says Ofer Abarbanel, CEO at Contact (ISR) Management and Consulting. "Clients have made only a few very simple CDOs and the CDS transactions we have done have tended to be the vanilla-type trades, we've steered clear of the complicated structures both as funded and unfunded trades."

Israel has a vibrant technology and medical services sector, with an educated workforce and an international outlook when it comes to financial markets. It's also a comparatively wealthy market, with large numbers of well-to-do retirees moving to the state.

Cautious investments

Although short selling and securities lending are established and approved features of the Israeli market, local investors have traditionally avoided short sales - the cautious culture of investors means they are just not a popular investment option.

Short selling is permitted provided that a corresponding securities lending transaction is in place to cover the short position, in accordance with the Tel-Aviv Stock Exchange rules.

"We've been able to have a successful market without short selling being a major factor," says one manager. "However, the fact that it is available adds stability - we certainly wouldn't want to see the option taken away from us."

Two tier

While securities lending is alive and kicking within Israel, there are two distinct types of market. The first is the local trading, which is pretty much controlled by the Israeli banks. Here, they tend to trade within themselves, with few external transactions taking place.

In part, this is down to the way the banks work. There is little standardisation even between the local banks, let alone with the international players. Industry standard contracts are not common, and are often in Hebrew, while the technology for securities lending transactions is not the same as that seen in the rest of the world.

"We have a large pool of funds and we don't have a problem fulfilling the requirements of our clients," says a representative of one local player. "As securities lending has developed, we have created a large amount of liquidity and reduced the risks as much as possible for our clients so that they are comfortable with the transactions we manage - our market profile is one of the reasons Israeli investors did so well during the downturn."

But this system, says Abarbanel, is inefficient and expensive. "The bank driven market is only for Israeli securities and is very limiting with respect to foreign investors who are hardly in this market," he says. "It's a large market, but it's an internal market, between Israeli banks and on Israeli securities.

"It's an expensive trade and haircuts are high, because banks dominate the market - it's a closed space. The banks are custodians to those mutual funds and they're kept as hostages - they can't do OTC trades without the say so of the banks."

The alternative is the OTC market, which has attracted a more international range of clients, as well as different lenders within the Israeli market. International and local pension funds, provident funds and insurance companies - mostly from Israel and Canada, the two Western financial markets that have done the best out of the credit crisis.

"What we've done is created relationships with these players and made GMSLA agreements on all types of US, European and Israeli securities, both equities and fixed income," explains Abarbanel. "We don't act as a counterparty, but as a middle office introducing broker. It's being the brains behind the trade - it's more sophisticated than the bank-driven trading.

"In the Israeli bank system, it's lenders who get low lending fees. We do payment in cash and payment in additional securities - so lenders get a five per cent lending fee and the ability to profit from those additional securities. This market is more attractive because it has lower haircuts and is more profitable for both sides.

"We also do a lot of re-use of collateral. Unlike Israeli banks where there is no netting and no re-use of collateral, we can do that and it creates a competitive environment for both lenders and borrowers."

As Israeli banks tend not to have the infrastructure - or the will - to trade internationally, the two markets complement each other well. There is, says Abarbanel, little desire on the part of the banks to change their systems, and they are happy to work with the OTC market.

"The banks are not looking to develop securities lending," he explains. "One reason for this is the fact that any time you try to develop a market it creates competition within that world.

"They are maintaining the market but they're not making the effort to improve it. Their systems don't work with other systems. We use systems that are up to international standards. It's two different attitudes.

"We are not trying to get the international market to transact with Israeli banks, but with Israeli pension funds and insurance companies. There are more securities for us to work with than all the Israeli banks have put together. The pension fund and mutual fund market is valued at $1.2 trillion, that amount is more than enough for everyone."

Regulation

Securities lending is permitted. At present, the SECH is not a party to the lending transaction. TASE rules prohibit intentional short selling unless there is a lending/borrowing agreement in place prior to the short sale. TASE regulations require that all intentional short sales not covered by a securities lending agreement, be covered within 24 hours of the creation of the position.

The regulations for short selling and securities lending appear in the TASE and SECH regulations. As noted above, the SECH is not a party to securities lending transactions. These are concluded between members and their customers or between two customers directly. All securities lending agreements must be reported to the SECH, whether they are transacted directly between two end customers without the involvement of the local custodians, or whether the lending is from the custodian.

The requirement to report stock borrowing transactions applies only in the event of short positions at the borrower's account. If borrower and lender made an agreement overseas and the lender delivers shares to the borrower's account, the borrower is not is short position, and in this case- the borrower's local custodian does not need to report the transaction to SECH as borrowing transaction.

Israeli companies trading on the Tel Aviv Stock Exchange will now be able to list on European stock exchanges without publishing an additional prospectus. An Israeli company seeking to list on one of Europe's stock exchanges will be able to use its Israeli prospectus, with an additional list of 15 disclosures required by the ESMA. Finance Minister Yuval Steinitz welcomed the decision, saying that the EU's regulatory standards were an "international yardstick." The ISA sees the ESMA decision as historic. After it was announced, ISA Chairman Prof. Zohar Goshen said that the Israeli market had "taken a great step forward in allowing Israeli companies to list their stocks for trading or raise capital in Europe." **SLT**

Incentives lure BarCap

Barclays Capital has announced plans to open a technology research and development centre in Israel, to be called the Israel Development and Engineering Centre (IDEC). The centre, which is to open in Tel Aviv, will supply development and engineering services meant to support Barclays' international financial activity. Barclays plans on hiring 200 Israeli employees trained in technology and finance.

The decision to establish the centre was made by the Barclays Group's management following the unveiling of the government's Competitive Advantage programme to promote high-tech industries in Israel, formulated by the Ministry of Finance and the Ministry of Industry, Trade and Labor.

The programme calls for the incentives for the establishment of financial R&D centres by multinational financial corporations in Israel. The centres will research and develop advanced technologies meant to serve and promote the global financial industry. The incentives will be provided by way of government participation in the costs of employment of new workers under a special programme developed by the chief scientist in the Ministry of Industry, Trade and Labor.

The establishment of a financial R&D centre by a bank is the first step in a comprehensive plan that aims to expand the scope of exports of financial services from Israel.

The plan, currently being drafted, is to include a series of recommendations for regulatory and tax measures applicable to financial entities and potential workers in the financial services industry, that could help Israel boost exports of these services. Minister of Finance, Dr. Yuval Steinitz, said: "In the high-tech industry, as in anything else, one has to choose between moving forward and falling behind.

"Therefore, when considering the continued future development of the Israel high-tech industry, we chose to strengthen research and development in the field of finance and to induce leading banks and institutions to set up R&D centres in Israel. Following a year's work we reached a breakthrough, and today we see the first vanguard. We welcome the decision of Barclays bank to set up an R&D centre in the State of Israel."

Andrew Witney, CIO at Barclays Capital, said: "We are very excited about opening the technological centre in Israel. The centre will benefit from Israel's large pool of talented high-tech workers and will provide solutions for Barclays Capital's technological challenges today and in the future."

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Big Interview

In the first of a two-part feature, SLT speaks to Rule Financial's Alec Nelson and Kevin Neville to gauge their views on the industry

BEN WILKIE

SLT: Firstly, could you tell me a little about Rule Financial?

Nelson: Rule Financial started out as a technology focused consultancy back in 1997, but we have been increasing our business consulting capability over the last six years or so by recruiting people who have worked for the banks in business roles – in securities finance our collective experience exceeds 150 years. We now have four business solution groups offering advisory and change consulting in securities finance, prime services, risk and legal. And we continue to offer strong technology "execution" and "managed support" services, able to provide project teams or individuals skilled in all mainstream technologies. This enables us to offer full end-to-end solutions to clients.

SLT: So how have you seen the business and technology change?

Nelson: I think securities finance as a business is interesting. No single part of it is particularly complex, but there are so many parts involved - it's like a 1,000 piece jigsaw puzzle, or a "fractal" – with ever more detail the closer you look; this is where the complexity lies, which makes it a challenging business to fully understand from a process and technology perspective. And of course it continues to change and evolve, always increasing in complexity.

Most of the banks use vendor systems, with only some of the larger ones having made the investment to build their own in-house systems. Having built Morgan Stanley's securities lending systems back in the early 90s, I fully appreciate how much time and money is required to go down the in-house build road; back then vendor options were limited so the decision was easier; today there's a lot more choice - a number of vendor's offer solutions covering differing parts of the securities finance landscape. But none cover it all, so a bank will need to integrate multiple systems and components in order to get the technology that it needs to operate.

The challenges for the technologists – both in-house and vendor - are how to keep up with the endless stream of changes; the demands arising from the last three years have required quite deep changes to the core of many systems – greatly increasing both the costs and the risks involved in making it all work 100 per cent of the time.

SLT: Who make up the majority of your clients?

Nelson: We focus mainly on the broker-dealers but also do some work with the agent lenders and custodial lenders. We also work with the buy-side.

SLT: It's been a tough financial market but securities lending actually hasn't fared too badly. How have you seen the last couple of years develop?

Nelson: Last year ended up being pretty tough for the market. By the middle of 2010, most banks had a fairly negative outlook for the rest of the year and it was a case of keeping the ship afloat and positioning it for 2011. The new year started well, but caution has returned as Q1 has progressed.

Neville: One of the difficulties with judging whether it was a good or a bad year is that specials within securities lending can carry most of the revenue stream for the entire year. And, it doesn't take too many 'specials' done in sufficient size to turn a bad year into a very successful one.

Because specials are so key, it doesn't require many takeovers or other market events to make a big difference. I think this year is going to be a lot better; as Alec has said already, we have seen more optimism about 2011, even if that has softened of late.

SLT: How has the trust within the market changed?

Neville: I don't think anybody fell foul over the last couple of years; very few people lost money as everything was collateralised; so the trust has always been there in the collateral and in the system. It's more to do with fear, and I think people are getting less scared. But some people we speak to are still standing back, and stories about the New Orleans fund is still having an effect.

SLT: Do you think most people on the fund side understand securities lending?

Nelson: I think they understand it to a point. Reinvestment risk of collateral is one area that was misunderstood. The general assumption was that it was an easy, safe way to generate extra earnings on a portfolio – receive cash collateral, reinvest the cash and get a return on that – it couldn't be simpler. But falling interest rates and volatility increased the risks of these investments; turning (easy) profits into real losses.

Neville: We don't do much cash collateral in Europe, so it's a US-centric view on the market, but there are still risks with non-cash collateral. There's a story about one bank taking convertibles as collateral for a stock - they thought it was great, it's a one-to-one trade. And then when things went wrong, it turned out the bank didn't have a convertibles desk so they couldn't trade it! What seemed to be reasonable collateral turned out to be something they couldn't get rid of when they needed to! There are still these complications; not so much about the loan, but about what you do with the collateral.

SLT: How have your clients changed their approach to collateral?

Nelson: If you go back three years or so, there was generally a lack of specialisation on the collateral management side of trades, with securities lending probably more advanced than OTC derivatives for instance. The Lehman default dramatically changed this, raising awareness of the importance of stronger management of the collateral being taken or given against trades and transactions.

There has been a tremendous amount of change to processes and procedures as the whole industry got to grips with the internal and external demands for more transparency and understanding of the risks and exposures they faced.

The banks have of course complied with all of the new demands – regulatory or internal - but I think a lot of this compliance has been achieved by tactical "band-aid" measures because their systems cannot be changed fast enough to provide the support needed in a more strategic way. My concern is that as and when business and volumes pick up, these tactical solutions will not be able to cope – it is a fragile part of a banks infrastructure at the moment.

SLT: How do you feel about the new regulatory environment?

Neville: I don't think there is too much regulation at all. Many people are bleating about central counterparties but I don't have a problem with that - why shouldn't we be able to have visibility of what stock is on loan? Currently there is limited reliable analysis of stocks on loan by data-providers - but in most other markets you get that information on a tick-by-tick basis. In the modern world we should see pretty much everything that goes on. So I'm a fan of greater regulation, with the more visibility the better.

The only issue I see is that if you regulate in the wrong way, people will just try to arbitrage the regulations. So if it is too prescriptive there will be a problem. But making people more accountable is utterly understandable.

Nelson: I agree that regulation is a good thing, but I do worry about the cost that it imposes on the industry - that cost has to be carried somewhere. Securities lending in particular is a very 'thin-margin' business, and I imagine there are lots of banks wondering if they can continue to make money from it going forwards. **SLT**

Kevin Neville
Head of prime services
Rule Financial

Kevin joined Rule Financial in April 2008. He brings unrivalled front office experience, along with deep understanding of all asset classes and trading methods. Before joining Rule Financial, Kevin gained extensive practical experience from a number of investment banking roles, including; Head of Design for the London Stock Exchange, running the Equity Derivatives Proprietary trading desk for NatWest Markets, Head of Equity Arbitrage at HSBC, and managing a mid-sized hedge fund.

Alec joined Rule in 2007. During his time at Rule Financial, Alec Nelson has consulted on business landscape, architecture and strategy for a number of leading investment banks. Before joining Rule Financial, Alec worked at Morgan Stanley for nineteen years, where he was responsible for the International Securities Lending, Prime Brokerage and Treasury systems. Working closely with the Front Office, Finance and Operations, he understands the tremendous value that global, integrated, 24x7 systems can bring to such clients.

Alec Nelson
Head of securities finance
Rule Financial

Euro trades

Part two of the ERC-ICMA semi-annual survey of the European repo market

RESEARCH REPORT

The dramatic surge in the share of the US dollar in June 2010 to 28.3 per cent from 15.9 per cent in December 2009 – which was driven by the exceptional transactions recorded in June 2010 – was substantially but not completely reversed by December 2010. The share of the US dollar fell back to 20.1 per cent.

Because the reversal in the share of the dollar was only partial, the shares of the euro and sterling did not recover all the ground lost in June 2010.

A notable feature of the latest survey was a sharp increase in reported cross-currency business to a record 5.6 per cent from 3.2 per cent in June 2010. It has been suspected in the past that cross-currency business was being under-reported (evidence included the fact that the proportion of dollar cash far exceeded the proportion of US collateral, suggesting many US dollar repos were being transacted against collateral denominated in other currencies).

The recent increase in reported cross-currency repo would seem to be an indication of underlying growth rather than wider reporting.

In data provided directly by the ATSs, there was a significant rebound in the share of the Swiss franc to 6.2 per cent from a record low of 2.6 per cent, mainly at the expense of the euro, which fell back to 89.1 per cent from 92.9 per cent. In contrast, the share of the euro in tri-party repo jumped to a record 81.8 per cent from 68.8 per cent, largely reflecting a fall in the share of the US dollar to 12.2 per cent from 22.6 per cent and, to a lesser extent, sterling (down to 4.9 per cent from 6.6 per cent).

The euro also fell back in voice brokered business (to 55.4 per cent from 58.6 per cent), as sterling, the dollar and the yen advanced (to 35.9 per cent from 34.5 per cent, to 5.0 per cent from 4.0 per cent and to 1.9 per cent from 0.7 per cent, respectively).

Just as the exceptional jump in the share of securities issued in "other OECD" countries from 10.5 per cent to 22.8 per cent dominated the June 2010 survey, so the (partial) retreat in the share of that collateral to 13.7 per cent dominated the December 2010 survey. German, Italian, UK and "other EU" collateral in particular regained share, notably German and UK government securities. The recovery in the share of Spanish collateral (to 5.2 per cent from 4.0 per cent)would seem to reflect the revival of the Spanish repo market. Greek collateral remains scarce (0.5 per cent). The growth in Japanese collateral (to 2.5 per cent from 2.0 per cent) matches the growth in the use of yen.

The share of government bonds within the pool of EU-originated collateral fell slightly to 76.6 per cent from 77.6 per cent. The share of government bonds within the pool of EU originated collateral also fell back in directly-reported tri-party business, touching 49.3 per cent, down from 54.3 per cent. There were significant increases in the use of Italian, Portuguese and Spanish collateral in tri-party repo (to 9.0 per cent, 1.2 per cent and 8.7 per cent from 6.9 per cent, 0.6 per cent and 3.5 per cent, respectively).

The historically low level of government securities in the main survey contrasts with the historically high levels of government securities in directly reported tri-party repo. The contrast is paradoxical, given that the fact that the tri-party market is the traditional venue for repos of non-government collateral. The increased use of non-government collateral in bilaterally-settled repo includes collateral issued in countries unaffected by sovereign credit concerns, so does not appear to be driven by a wish to diversify out of government securities issued by countries in fiscal difficulties.

> There were significant increases in the use of Italian, Portuguese and Spanish collateral in tri-party repo

The share of Spanish collateral increased in electronic trading (to 7.0 per cent from 3.8 per cent), while the share of Irish collateral fell back (to 0.8 per cent from 1.7 per cent).

The share of floating-rate repos fell back to 7.6 per cent from 10.1 per cent in the main survey and to 12.8 per cent from a record 14.3 per cent in directly-reported electronic business. This may reflect growing expectations of official interest rate changes.

There was an unwelcome increase in December 2010 in undocumented sell/buy-backs to 3.6 per cent from 2.6 per cent.

Anecdotal reports of increasing volumes of long-term repos by banks seeking to lock in liquidity, in part, to meet regulatory requirements, are not reflected in the survey data.

The unwinding of the exceptional transactions recorded in June 2010 pushed the share of forward-start repos down to 6.7 per cent from a record 18.2 per cent in June 2010, closer to historical levels. The main beneficiaries of this fall in forward start transactions were very short-dated (1-day to 1-week) and 1 to 3-month transactions (all short dates increased to 62.5 per cent from 55.3 per cent and 1 to 3-month transactions to 15.2 per cent from 11.3 per cent).

Short-dated transactions also grew in voice-brokered business, to 31.6 per cent from 26.9 per cent.

It should be noted that the sharp increase in long-term tri-party repo shown in the data contributed directly by tri-party agents (to 18.9 per cent from 1.1 per cent) was the result of an improvement in reporting by one triparty agent rather than a shift in the market. Otherwise, it can be seen that tri-party business is dominated by one-day and open repos.

There was a reduction in the concentration of surveyed repo business, again reflecting the unwinding of the exceptional transactions recorded in June 2010, which had produced a sharp increase in the reported concentration of the market. Thus, the top 10 survey participants accounted for 61.7 per cent of total surveyed business in December 2010, compared with 68.8 per cent in June 2009. In terms of the Herfindahl Index, market concentration in December 2010 had fallen back to 0.064 from 0.108 in June 2010. However, this is still well above the 0.041 recorded in June 2007, prior to the crisis. The competitive advantage gained as a result of the crisis by institutions with strong balance sheets, which are able to exploit the weakness or disappearance of competitors, would therefore appear to have persisted.

The dramatic surge in the share of the US dollar in June 2010 to 28.3 per cent from 15.9 per cent in December 2009 – which was driven by the exceptional transactions recorded in June 2010 – was substantially but not completely reversed by December 2010. The share of the US dollar fell back to 20.1 per cent.

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Conclusion

The December 2010 survey was dominated by the unwinding of most (but not all) of the exceptional transactions reported in the June 2010 survey. These transactions propelled the headline number of the survey by over 20 per cent to EUR 6,885 billion in June 2010 and, being concentrated in forward-start repos of US dollar cash against "other OECD" collateral, had depressed the market shares of other types of transaction. But with most of these transactions apparently running off by December 2010, the pattern of business in the repo market swung back towards that of December 2009 (although the increases in the shares of the dollar and "other OECD" collateral have only been partially reversed).

Adjusting for the unwinding of exceptional transactions, it would appear that the market has resumed a more modest (and sustainable) path towards recovery. Thus, the headline number in December 2010, although more than 15 per cent below June 2010, was about 6 per cent above the December 2009 total of EUR 5,582 billion and close to that of June 2006.

It is now easier to discern once again the major trends within the market. These are the continuing growth of electronic trading, the shift towards greater use of CCPs (accessed not only through electronic trading but also by post trade registration) and a recovery in tri-party repo. The growing use of CCPs and tri-party repo reflect the continued greater sensitivity to risk following the recent crisis. **SLT**

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Moving Forward
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Quants: the hunt for new ideas

Will Duff Gordon takes a look back at the recent FactSet Investment Process Symposium

DATA PROFILE

Despite exciting developments in the world of non-traditional ways to predict share price movements (Twitter can now predict the Dow Jones movements), it remains the case that value, growth and momentum remain the core factors.

Many funds who are masters at screening financial information assembled at the FactSet Investment Process Symposium in Florida this week to discuss and share their views on the state of investing. Quant style investing has had a tough few years, but this event proved they are rebuilding their models, which are set to pay dividends.

FactSet Research Systems (consolidators of financial and economic information to support the investment process) were the hosts and reinvigorated an event that had taken a two-year sabbatical. We were there to speak and participate in a place where many of the United States' largest asset managers had gathered. Most attendees worked for companies who lent their shares, but very few were major short sellers. Some had launched 130:30 funds but the consensus was that these strategies were facing an uphill struggle at present.

It is worth repeating one or two of the messages given by Blackrock's managing director, Ronald Kahn in his opening address, since these themes ran through the whole event. He laid bare the lessons that people are trying to learn after the credit crunch. There is a tacit understanding that quantitative investing has struggled ever since the redemption-led wobble in August 2007. Fortunately, the momentum gained by the steady and strong returns achieved from this group in the years prior ensure that they retain the faith of many investors.

Clearly, moving away from running a "generic" model is key but this is not as easy as it sounds according to Kahn. Incorporating an element of ESG (environmental, social, governance rating) into stock selection was put forward by Trillium Asset Management as ethical AND profitable, but it did not sound like this was yet the norm given how few data providers exist in this area. As luck would have it, Green Mountain Coffee Roasters (NASDQ:GMCR) are a top ethical pic AND rose 40 per cent this week! Acadian made a case that quant investing in emerging markets is very possible and given the incredibly interconnected world we live in, it seems likely that more and more models will take account of sentiment in these economies.

I enjoyed the Blackrock speaker's anecdote about how the machine became more important than the man in recent times – just because running a back test is fast and furious doesn't mean one should test a factor if you can't articulate why it would be additive in the first place. Thinking harder is what it is all about and mastering tools like Factset leaves fund management firms more time to do this.

On the subject of thinking harder, Dan Berenbaum cut through the hype surrounding semiconductor companies with a tour de force. This was particularly insightful given how little we know about how the Japanese disaster will affect this industry, seeing as they are major players in this area. Another footnote was the suggestion that people who are making tablet sales predictions (iPad, etc.) often have no recourse to how many computer notebooks are being bought each year.

Day 1 was rounded off with an excellent talk by Kenneth Rogoff, Thomas D. Cabot professor of public policy and economics, Harvard University. He was the first person I met at the conference straight off a plane from London and little did I know that he was the IMF's chief economist a few years ago and one of Sweden's key advisers. One of the many interesting predictions was that Portugal will default this year, but this will not be contagious since, after all, most major economies have defaulted many times when you look over the past few hundred years. He is also skeptical that China will overtake the US as the world's largest economy any time soon.

An interesting two days indeed. **SLT**

Will Duff Gordon
Media director
Data Explorers

1st Annual Conference on Canadian Securities Lending

CASLA Canadian Securities Lending Association

Date: 4 May 2011
Location: Toronto
Website: www.canseclend.com

In this inaugural event, CASLA brings together Canada's key players to speak on the issues affecting its industry.

New York Securities Financing Forum

dataexplorers

Date: 26 May 2011
Location: New York
Website: www.dataexplorers.com

The Securities Financing Forum is the one event that you really must attend. Senior delegates from the industry will be in attendance for a series of panel discussions and high-level networking.

Network Management 2011

Network Management 2011 NeMa

Date: 15-16 June 2011
Location: Dubrovnik
Website: www.icbi-events.com/nema/

With over 300 attendees from the Network Management and Securities industry in 2010, NeMa has become THE most important event of the year for the network management community - bar none.

ISLA 20th Annual International Securities Lending Conference

ISLA International Securities Lending Association

Date: 28th-29th June 2011
Location: Penha Longa (Lisbon/Sintra)
Website: www.afme.eu/isla2011

ISLA is pleased to announce the date and venue for its 20th International Securities Lending Conference. The event will take place between 28th and 30th June 2011 in Penha Longa (Lisbon - Sintra).

Industry Appointments

Abel Aronovitz, director, institutional sales at OneChicago and the company have parted ways after two years, it is understood Aronovitz felt the time was right to move on to the next step in his career, his next move is not known at present.

This is the second recent departure; **Don Horwitz**, general counsel and chief regulatory officer at the exchange, has also moved on.

BTIG Ltd has expanded its London office with the appointment of three sales trading professionals: **Chris McGale**, **Jon Clements** and **Adam Bowers**.

"Chris, Jon and Adam add depth and experience to BTIG's industry expertise in pan-European sales and trading," Gary Hayes, CEO of BTIG in Europe, said. "BTIG has expanded its regional and international capabilities over the last five years with offices now in London, Hong Kong, Singapore and Australia as well as 10 US locations."

McGale joins BTIG from Bryan Garnier & Co., where he was a sales trader. He began his career as a buy-side analyst in Dublin before joining Merrill Lynch/Smith New Court, where he worked for more than 10 years and held various positions, including managing director of European equities and Irish country manager. After Merrill, McGale returned to Dublin with Numis Securities and was later head of institutional sales at Pali International.

Clements joins BTIG from AllianceBernstein, where he spent 10 years trading European equities in New York and London. Prior to AllianceBernstein, Clements was a UK equities trader with Credit Suisse Asset Management. He has more than 19 years of experience trading UK and European markets, and began his career at Kleinwort Benson, where he was a market maker in the banks and insurance sector.

Bowers joins BTIG from ITG/Hoenig & Company, where he spent eight years covering institutional and hedge fund accounts on a global basis. Prior to that, Bowers was an equities market maker at HSBC and a financial futures trader on LIFFE with both Lloyds Futures and ING Barings.

"BTIG now has more than 400 professionals worldwide and offers brokerage and related services in 11 areas," Hayes added. "We continue to grow our European presence with experienced professionals that have allowed us to expand our product offerings, increase our distribution capabilities, and provide further services to our clients."

Oscar Huettner has joined BondLend as director and product manager. Huettner will join the fixed income securities finance platform in April and will report to BondLend's CEO, Brian Lamb. He will be based out of the company's New York Headquarters.

Huettner joins BondLend from Barclays Capital and has previously held positions with Mizuho, DLJ and Salomon Brothers. He has 25 years of collective experience in the global financing markets with a background of managing repo trading desks in London and New York. Additionally, his experience spans involvement with automated trading, central counterparty clearing and tri-party funding. Huettner has an economics qualification from Lafayette College and an MBA from the Joseph M. Katz School of Business at the University of Pittsburgh.

Brian Lamb, CEO of BondLend, stated: "We are excited to welcome Oscar to the BondLend platform. He brings a wealth of experience and strong relationships within the fixed income community. We look forward to growing the brand with Oscar as we continue to drive efficiencies and automation for our clients."

Huettner commented: "Bondlend's platform represents a major step forward in the evolution of the fixed income securities finance market. I am very much looking forward to joining the team with the goal of establishing Bondlend as the premier soft touch dealer to client trading solution in the global fixed income markets."

Gar Wood Securities has tapped options industry veterans **Mark Oakley**, **Jeffery Fried** and **Steven Hessing** to manage Gar Wood's new CBOE Brokerage Services unit. This newly formed department spearheads the expansion of the firm's derivatives execution services, ensuring that Gar Wood's prime brokerage offering continues to effectively address the execution needs of its ever expanding list of clients.

Gar Wood CEO Bob Jersey stated, "Gar Wood is committed to expanding its strategic offering, enhancing service to clients and continually providing cost-effective solutions to address their trading, risk management and operational needs. We are very pleased to have Mark, Jeff and Steve join our team and we look forward to the added value that this strategic move brings to our clients."

Oakley, serving as senior vice president, joins from Citigroup Global Markets where he was a vice president and a broker on the floor of the CBOE for 35 years. Serving as vice presidents, Fried and Hessing each have enjoyed long careers on the floor with Susquehanna and Merrill Lynch as vice president, respectively. Throughout their careers this trio, which collectively represents over 80 years of floor execution experience, has been dedicated to high quality client service on the CBOE.

Oakley stated: "I'm very excited to be a part of the Gar Wood team. The firm has a unique client-centric mission that fits perfectly into my career-long emphasis on high quality client service. I look forward to providing that same high level of client execution and option strategy support to Gar Wood's expanding client list. I believe that our floor operation will greatly compliment Gar Wood's comprehensive array of services including multi-asset class trading coverage, best execution, portfolio margining, stock lending, margin financing, technology, operations, reporting, traditional and seed capital raising, and cap intro."

Oakley went on to say, "We are pleased to be able to offer our clients execution services on all products listed on the CBOE. But we are especially proud to announce Jeff Fried will serve our clients as a permanent presence in the VIX trading pit. We believe this product to be a superior tool for hedging risk, and we feel that currently the VIX is greatly under-utilised as a hedge for risk in a world that offers no shortage of geopolitical and economic risks." **SLT**

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Jon Kwok

In the third of our new series "A coffee with..." Securities Lending Times gets to know Jon Kwok, product analyst at RBC Dexia Investor Services

Tell us about your career to date?

I was hired as a business analyst working for a consulting company called Software Architects in Minnesota. I gained valuable experience with writing business requirements and performing user acceptance testing for a client developing smartcards. When the IT bubble finally burst the company had to cut all non-locals. I should have known it was coming when the company fridge had replaced fruit juices with water.

After being released from my contract, I decided to head back to Toronto. I contacted a friend who got me in to CIBC Mellon in the operations group facilitating cash settlements. From there, I was able to move into the Capital Markets group as a product analyst working with their range of value added products. My main role was to assist in the identification of revenue opportunities through data analysis, assist with the implementation of a new commission recapture product and complete system testing for compliance with SOX 404 on a large securities lending application.

From there, I went to RBC Dexia where I have been the last five years and thoroughly enjoying it. At RBC Dexia, I strictly specialise and work within the securities lending product line within Market Products and Services group. I am given the opportunity to work on many initiatives to increase revenues streams through collateral expansion, new emerging lender/security markets and assist with the development of a new client reporting application.

How did you get into the securities lending industry?

In my previous company, I was given the opportunity to cross-train and learn different product lines including foreign exchange, commission recapture and securities lending. At the time, there was an opportunity to help assist with some of the analytics for client relationship reviews and benchmarking for securities lending. From there, I learned the fundamentals of the product and been doing it ever since.

Was it different to what you expected, if so how?

I really didn't know much about securities lending initially, only that it was a high revenue product for capital markets so I went in with an open mind. The industry is constantly evolving and there will always be an opportunity to increase my knowledge. The dynamics and what was important five years ago are completely different than what it is today. This is what makes it interesting and keeps me wanting to seek more.

Has anyone helped or inspired you during your career?

I was very fortunate to work with some amazing people over the years that taught me so much in my career. From my days at CIBC Mellon, Rob Ferguson gave me my first break in securities lending and provided me with guidance and opportunities to learn the product. At RBC Dexia, the head of securities lending, Yvonne Wyllie has provided me the opportunity to learn new things, participate on new initiatives and supported me along the way. It is an added bonus to work with industry leading people that you ultimately respect and who have a genuine interest in your well-being.

If there is one thing you could change about the industry what would it be?

Better co-ordination amongst various regulatory authorities globally. It's really affecting our industry which is hindering market demand.

How did you find working through the industry's biggest ever crisis?

Busy. Everything seemed to move at a faster pace and the importance of client communication throughout the crisis could not be more paramount. The process went pretty seamless for our firm, we proceeded with an orderly closing down of outstanding loans to Lehman Brothers, keeping every client updated on a minimum daily basis until the securities had been repurchased and returned. We definitely ran a lot of client and borrower data and performed lots of analysis.

What are your ambitions?

Four months ago I became a father, so first and foremost is to become a good parent and being able to spend some quality time with him every single day. On the work front, we have a lot of important initiatives on the go right now at RBC Dexia and I am fortunate to have the opportunity to contribute on some of them. Seeing these projects get through to the finish would be rewarding in the coming year.

Outside of work what are your interests and pursuits?

I love to play boardgames like Risk, Taboo, Scattergories and Apples to Apples. I also like to watch tons of sports and it's hard to get me off the couch on Sunday afternoons during NFL football season. I love to go bass fishing during the summer in Curve Lake. I have been playing on a co-ed softball team for the last seven years and love to play golf but unfortunately, still struggle at it. I have also been taking some Muay Thai boxing classes for about a year to keep in shape. I also like to play some poker with friends at home games. For some reason, I can never spot the sucker in these games….

With an unexpected $10 million bonus what would you do?

I would pay off all my bills, buy a new house for myself and parents, take care of my son's education, do some investing and help a few people and charities. I think I would like to have a few more kids and would still live a simple life in luxury, just won't be eating at the food court as much anymore.

If you weren't working in securities lending what would you be doing?

I love reading and talking about all kinds of sports. I always wanted to become a scout for a club in the NHL, MLB or NFL so I could attend unlimited number of games for free. **SLT**

Favourites

Food
Bluefin tuna and abalone

Sport:
Mixed Martial Arts (MMA)

Music
Baby lullabies at the moment

Movie
Rounders and original The Karate Kid

Book:
The Baby Whisperer Solves All Your Problems

Holiday:
Hong Kong

Celebrity:
Bruce Lee