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ISLA launches French toolkit

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The International Securities Lending Association (ISLA) and Societe Generale Securities Services (SGSS) have published a guide to enhance French mutual funds and other investors' understanding of the securities lending market.

The guide is based on English language versions of documents first produced in late 2010 by a group of leading financial trade associations, including ISLA. The French versions include an introductory guide and a checklist for investors who are contemplating starting securities lending programmes for the first time.

Whilst much has been written on the subject of securities lending, most of the materials available are aimed at readers with an existing degree of understanding of the business. Trustees and others with responsibility for the oversight of investments are challenged to stay abreast of the large array of investment techniques available to them.

Kevin McNulty, chief executive of the International Securities Lending Association, commented: "Ensuring that beneficial owners of securities, such as pension funds, have access to straightforward advice about securities lending remains an extremely important objective of ISLA. We are very pleased to work with Societe Generale Securities Services in developing these materials for the French marketplace. The documents complement the broader range of materials already in existence aimed at educating investors on securities lending and we hope to produce further versions for other markets shortly".

Anne-France Demarolle, head of liquidity management, Societe Generale Securities Services, added: "Societe Generale Securities Services is already an active player in securities lending, providing access to this source of revenue to a wide range of investors. We are pleased to team up with ISLA to further promote securities lending within the French-speaking investment community, enabling us to facilitate clients' access to our service through our agent lending programme".

NEWS**IN**BRIEF

Loanet expands services to AQS

SunGard has expanded its Loanet securities finance solution to automate borrow order submissions to Quadriserv's AQS securities lending platform, which is a central counterparty-based market that offers automated securities lending trading in over 5,000 underlying equity, ETF, index, and ADR products.

Integrating their AQS borrowing activity into their pre-existing automated Loanet Centralised Order Routing workflow will help Loanet customers increase efficiency, streamline their operations and create a true straight-through process for borrowing in the AQS marketplace.

read**more** p3

Bahrain to allow short selling

The Bahrain Stock Exchange will introduce short selling in 2012, as part of its efforts to be upgraded to emerging market status on the MSCI index.

Speaking to Bloomberg, the exchange's deputy director Khalifa Bin Ebrahim Al Khalifa said the exchange wanted to move out of its current frontier market status.

Short selling measures are planned for the first quarter of 2012, with Delivery versus Payment also planned.

INSIDE SECURITIES**LENDING**TIMES

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Loanet expands services to AQS

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Borrowers can use their existing Loanet order routing interfaces, eliminating the need to manually submit AQS orders or develop or support separate interfaces to AQS. Loanet captures executed and non-executed AQS orders directly into its straight-through-processing environment.

John Grimaldi, executive vice president of SunGard's North American securities operations and securities finance business, said: "The securities finance industry continues to move towards automated trading and is constantly looking at ways to streamline its trading activities. Providing a single point of access to both the AQS and bilateral marketplaces moves the industry towards a centralised trading infrastructure while improving efficiencies around the borrowing process."

"Seamless connectivity to AQS through Loanet greatly advances our goal of expanding access to the AQS marketplace to a broad range of industry participants," Bruce Turner, Quadriserv's president and chief operating officer, said. "To that end, SunGard's Loanet Order Routing Service has been a tremendous success, and we are pleased that corresponding order flow is migrating to the AQS centrally cleared model."

Lyxor Hedge Fund Index records positive performance

The Lyxor Hedge Fund Index has recorded a positive YTD performance of +0.30 per cent, despite a difficult month of May for alternative strategies.

The Lyxor Hedge Fund Index was down -1.80 per cent in May. Year-to-date performance as of May 2011 is up +0.30 per cent. The month of May was quite volatile and negative for the majority of Hedge Fund strategies.

The top performing strategies year-to-date are Lyxor L/S Equity Market Neutral (+3.52 per cent), Lyxor Merger Arbitrage Index (+3.02 per cent), and Lyxor L/S Equity Variable Bias Index (+3.00 per cent).

The Lyxor Hedge Fund indices are investable, asset-weighted indices, designed to offer investors straightforward access to hedge fund performance. The indices are based on Lyxor's managed account platform that covers all the major hedge fund strategies and benefits from a high level of transparency and risk control, while ensuring weekly liquidity. The Lyxor Hedge Fund Index range comprises 17 indices ranging from global to strategy and thematic indices. The Lyxor Hedge Fund Index (Global Index) reflects the average performance of all 14 strategy indices, thereby offering direct exposure to the global hedge fund universe.

Wedbush acquires Lime Brokerage

Wedbush has acquired Lime Brokerage LLC, a provider of ultra low-latency, ultra high-throughput trading technologies and high-volume agency brokerage services.

Lime's high-performance trading technologies and Wedbush Securities' Advanced Clearing Services are now fully integrated to provide expanded high-speed solutions for the execution, market data, and risk control requirements of both firm's clients. The result is a suite of products for ultra low-latency, low-cost, and high-volume equities, options and futures trading. Moreover, Lime provides a technology platform from which Wedbush plans to develop and deliver innovative brokerage services in multiple asset classes and geographies for its buy-side, professional, and individual clients.

Founded in 2001 and privately-held, Lime will operate as a wholly-owned subsidiary of Wedbush, headquartered in Los Angeles and the parent company of Wedbush Securities, the #1 ranked liquidity provider on the NASDAQ exchange for the past five years. Jeff Bell will assume Lime's CEO position in addition to his responsibility as head of Wedbush Securities' Clearing and Technology Group. Eric Wedbush and Gary Wedbush, both executives at Wedbush, will join Lime's Board of Directors. Lime's employees will continue to be located at offices in the Technology Center in Waltham, MA, New York City, and data center in Jersey City, NJ. Additionally, Lime will continue to manage co-location sites at major liquidity venues.

"Lime has long been viewed as a technology leader by the high-frequency trading community and is a perfect complement to our market-leading, high-volume clearing operations. We are especially excited about the enhanced technology capabilities Lime's outstanding engineering team will bring to our entire firm," stated Eric Wedbush, president of Wedbush. "This acquisition is a major advancement in our mission to deliver to our buy-side clients the highest-speed, lowest-cost DMA and algorithmic trading services in the industry," added Gary Wedbush, executive vice president and head of capital markets for Wedbush Securities.

"Lime's clients are among the most sophisticated and demanding traders in the world. The integration of Lime's low-latency technologies in execution, market data, and pre-trade risk controls with our full-service execution and clearing services provides the market with immediate benefits not available elsewhere. We plan to leverage Lime's technology capabilities across all of our business lines to benefit of our entire client base. Accordingly we anticipate retaining and growing Lime's exceptional management, technology, and operations teams," said Jeff Bell.

"Wedbush is one of the most respected names in the financial services industry, through its vision, values and client-focused service model, and we are extremely proud to now be part of an organization we've always admired. Our clients and prospects will see tremendous value from the tight integration with Wedbush's clearing, execution and broader range of service offerings", stated Alistair Brown, co-founder of Lime Brokerage.

State Street appointed global securities lending agent for REST

State Street Corporation has been appointed global securities lending agent to REST Industry Super, Australia's largest industry superannuation fund by membership.

The appointment follows the announcement in January this year of a long-term superannuation servicing agreement between State Street and

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REST Industry Super which includes custody, fund accounting and complex tax services.

Ian Martin, senior vice president, head of Global Services, South East Asia, Asia Pacific/head of Global Markets, Australia & New Zealand, said the appointment was a significant milestone for State Street in Australia and demonstrated the group's ability to work together to provide comprehensive solutions for clients.

"State Street is committed to growing its business to service the needs of Australia's $1.3 trillion superannuation fund sector, and we are pleased to be able to offer this extra level of assistance to REST, along with the initial services announced five months ago," he said.

Francesco Squillacioti, State Street's Asia Pacific regional business director, securities finance, said: "Securities lending is an area where funds with extensive domestic and global holdings require specific support and technical expertise. State Street is consistently recognised in this area for its industry-leading, comprehensive and innovative solutions for clients."

OneChicago offers OATS OSO services

OneChicago is now offering Order Audit Trail System (OATS) Order Sending Organisation (OSO) services to its customers. The new service supports firms executing point-and-click traded EFPs (Exchange for Physical) on the exchange.

The OSO services will facilitate firms meeting their Financial Industry Regulatory Authority (FINRA) OATS regulatory reporting obligations. In addition, the new service is designed to help firms trading EFPs eliminate inefficiencies caused by manual processes and reduce operational risk.

"Our clients are always looking for efficient ways to comply with regulatory mandates," commented David Downey, CEO of OneChicago. "Firms can rely on our OSO to meet their FINRA obligations, improving access to OneChicago point-and-click traded EFP marketplace for customers and proprietary traders."

The OneChicago OCX.NoDivRisk EFP trade is an exchange traded, central counter party cleared, economic equivalent to OTC equity swaps, equity repos and securities lending transactions.

Athens suspends banks trading

The Athens Exchange has suspended trading, including securities lending and derivatives activity, in TT Hellenic Postbank and T Bank until the two firms confirm the progress of merger discussions.

The board of Hellenic Postbank is expected to meet with angry employees, who are mostly against the sale of the bank. They disagree on the absorption of T-Bank, as they believe that it could simplify procedures for the sale of Hellenic Postbank.

T-Bank announced that the board of the bank will meet on Friday, June 10, to discuss the merger proposal.

NY Fed changes SOMA securities lending rules

The Federal Reserve Bank of New York's open market trading desk has removed the $750 million issue-specific limit from its System Open Market Account (SOMA) programme.

All other programme terms and conditions will be maintained, including the 25 percent issue-specific and $5 billion aggregate limits.

Citi to open Luxembourg securities lending desk

Citigroup Global Markets has formed a new Luxembourg entity to provide securities lending services to clients both within Luxembourg and throughout Europe.

Citigroup Global Markets Luxembourg is a wholly-owned subsidiary of Citigroup Global Markets Limited, Citi's FSA regulated principal European broker-dealer. Citigroup Global Markets Luxembourg was granted a licence by the CSSF under the law dated April 5, 1993, and is regulated as a professional carrying out securities lending ("professionnel effectuant du prêt de titres") in accordance with Article 28-5 of the 1993 Law.

Charles Denotte, Citi country officer for Luxembourg, said, "Luxembourg is a stable political and financial environment with a robust and respected regulatory regime and is currently the

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second-largest investment fund centre globally. An ability to access these funds from Luxembourg will give Citi a strong competitive advantage amongst its peers and will help us to further grow our Luxembourg franchise."

Nick Roe, global head of prime finance, added, "The establishment of dedicated capital markets legal entity in Luxembourg is a key step for Citi as we continue to expand our business, and the depth of our product and service offerings. In addition, it reinforces the commitment Citi has to growing its franchise in Luxembourg and ensures that we are uniquely positioned to offer clients an integrated execution, prime brokerage, securities financing, fund administration and custody platform."

Citi has had a presence in Luxembourg since 1970, providing Global Transaction Services, Global Relationship Banking and Funds Industry Services and currently employs 240 people.

Eurex launches Polish single stock futures

Eurex will launch 19 single stock futures (SSF) on leading Polish companies on 27 June 2011. The new listings reflect customer demand for derivatives based on shares from one of the largest economies in Eastern Europe. The new SSF contracts will be based on 19 shares of the Polish blue chip index WIG 20 (except CEZ) and denominated in euro. The launch extends Eurex's SSF offering with a new country, bringing the total number of covered countries to 21.

"As Eastern European countries become more and more important for our customers and investors, demand for products based on companies listed in these markets also increases. Therefore, we have extended our offering and launched contracts covering companies from one of the biggest Eastern European markets", said Peter Reitz, member of the Eurex Executive Board. "Our current SSF suite gives customers greater flexibility in executing trading strategies in more than 850 names in Europe and internationally."

The new Polish SSFs will extend the number of covered Eastern European and emerging markets to four. Volumes in Russian SSFs, the largest emerging market segment at Eurex, have risen steadily since their launch in 2007: In 2010, contracts totaled more than 680,000, while year-to-date volume is almost 300,000 contracts.

The specifications of the new contracts are comparable to the other European listings. Each contract represents 100 shares and is cash settled. They will have expiry dates up to three years for the next 13 calendar months, plus the two following annual contract months out of the December cycle. The new Polish single stock futures also are eligible for Eurex's Block Trade Facility.

SunGard to offer same day securities lending data

SunGard is now offering same day securities lending data through SunGard's Astec Analytics Lending Pit solution, designed to help customers improve price discovery, increase profitability and decrease risk.

Broker-dealers and lending agents currently rely on data that is at least one to two days old, making it difficult to monitor the fast moving securities lending market or formulate the optimal trading and investment decisions.

SunGard's Astec Analytics Lending Pit updates global securities-level rate and volume information several times throughout the day, providing customers empirical evidence about the latest market sentiment. In addition, data from Europe, the Middle East, Africa and Asia Pacific is posted around the clock, while US data is streamed in near real-time on a 24-hour basis.

Tim Smith, executive vice president of SunGard's Astec Analytics business unit, said, "In the current securities lending environment, sentiment can change completely in the span of only a few hours. Traditionally, these intraday movements are hard to predict and even harder to fully capitalise on. By providing market data throughout the day, SunGard can help securities lending professionals better understand market activity and make more informed borrowing and lending decisions."

Clearstream and Cetip launch collateral outsourcing service

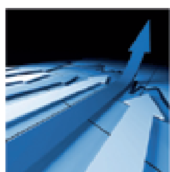
Clearstream and Cetip will launch their collateral management outsourcing offering in mid-July 2011.

The new service is designed for the Brazilian market and will enable Cetip clients to efficiently handle their collateral exposure in their time zone and real-time, thus strengthening their risk profiles across OTC derivative activities. The service will build on Clearstream's proven collateral management infrastructure. It will be offered on a fully automated basis incorporating auto-allocation, auto-substitutions and optimisation of the underlying collateral, leveraging the full benefit of collateralisation.

The triparty collateral management service will initially focus on the collateralization of OTC derivative exposures managed via Cetip. The service will enable Brazilian participants to mobilize, domestically, assets eligible at Cetip and SELIC, the central depository of securities issued by the National Treasury and the Brazilian central bank. In a second phase, it is envisaged also to target assets eligible at Clearstream in order to fulfill collateral obligations out of an enlarged collateral pool.

Jeffrey Tessler, CEO of Clearstream, said: "Efficient handling of collateral continues to be a major industry concern around the globe. We have developed a pioneering solution with and for Cetip that can serve as blueprint for other market infrastructures. The model we have developed with Cetip is subject to great interest in the international financial community, mainly due to its unique and innovative character. We will also continue to grow our collateral pool, the Global Liquidity Hub, to further increase the attractiveness of this service."

Luiz Fernando Vendramini Fleury, CEO of Cetip, said: "The triparty collateral management system developed with Clearstream meets the needs of both market participants and our local regulatory bodies. The new service helps to increase liquidity in a more secure and transparent manner - and at lower cost. The collateral management service provided by an authorised



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outsourced company and under the supervision of the regulating bodies brings more security to the Brazilian OTC derivative market."

Pirum releases new reporting for SEC rule 17a-13

Pirum has released new reporting to facilitate compliance with SEC rule 17A-13, which requires borrowers to regularly confirm their on-loan positions with their lenders. This will benefit market participants looking to reduce the risk and burden of manual compliance with this requirement.

Pirum's solution automates the secure delivery of monthly, quarterly and year-end position reports to counterparties. Pirum's new reports automatically highlight any positional differences between a pair of market participants and are in a format ready for ready for sign-off by an authorised individual, eliminating the need to manually identify any discrepancies.

Rupert Perry, chief executive of Pirum explained: "We have developed this new reporting functionality following a number of requests from our customers to help them provide these control reports in compliance with SEC rules. Our customers tell us that these new reports will enable them to fully satisfy the SEC requirements with much less manual effort than is required today."

Clearstream's May 2011 figures

In May 2011, the value of assets under custody held on behalf of customers registered an increase of three per cent to €11.3 trillion (compared to €10.9 trillion in May 2010). Securities held under custody in Clearstream's international business stayed flat at €5.9 trillion compared to same month last year while domestic German securities held under custody increased by seven per cent from €5.0 trillion in May 2010 to €5.4 trillion in May 2011.

In May 2011, 3.26 million international settlement transactions were processed, a three per cent decrease over May 2010 (3.37 million). Of all international transactions, 78 per cent were OTC transactions and 22 per cent were registered as stock exchange transactions.

On the German domestic market, settlement transactions reached 7.72 million, five per cent less than in May 2010 (8.11 million). Of these transactions, 68 per cent were stock exchange transactions and 32 per cent OTC transactions. But year-to-date May 2011 is 11 per cent (+ 5.5 million) above same period last year.

For Global Securities Financing (GSF) services, the monthly average outstanding reached €552.7 billion. The combined services, which include triparty repo, securities lending and collateral management, collectively experienced a rise of eight per cent over May 2010 (€509.6 billion).

In the Investment Funds services, 0.43 million transactions were processed, an eight per cent decrease over May 2010 (0.47 million). But year-to-date May 2011 is with 2.37 million transactions 15 per cent higher than same period last year (2.07 million).

State Street launches mobile App for iPad

State Street has launched a new mobile application for the iPad, State Street Springboard, which will be available in the Apple App Store later this year. State Street Springboard allows clients to view essential portfolio information that is specifically designed for mobile users and leverages the content and information from my.statestreet.com, State Street's online information delivery platform that is the secure, single- client entry point to a full suite of sophisticated market data and analysis applications.

Targeted at executive-level portfolio and fund managers, the initial release of the app includes the ability for users to view their en-

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tire investment portfolio at a glance, including risk-exposure analysis, Net Asset Value (NAV) summaries, and fund flows. Clients will also have access to thought leadership, including the Vision series of publications. The current app will serve as a flexible foundation for future updates that will expand on the initial release, provide additional functionality and broaden the content available.

"As part of its multi-year business transformation programme, State Street continues to invest in new technologies, like mobile applications, to introduce new or strengthen existing services that meet the changing needs of our clients," said Chris Perretta, executive vice president and chief information officer for State Street. "The rapid adoption of the iPad in the financial services industry makes it a natural fit for our first foray into mobile applications for our institutional client base."

The app will be available to existing State Street clients in the Apple App Store and a State Street client log in will be required for access. State Street will continue to explore other business applications for mobile technologies while it develops additional device and operating system deployment plans for this app.

"Clients are increasingly focused on risk management and are relying on mobile devices more than ever for immediate access to critical information in a rapidly changing global market," said Pat Centanni, executive vice president and head of global product management. "State Street Springboard is extensible and customizable, enabling mobile users to fine tune their experience so that critical information and market insights are easy to access."

Broadridge launches Gloss prime broker solution

Broadridge Financial Solutions has launched its post-execution processing solution for prime brokers and investment banks. Based on the market leading multi-currency trade processing and settlement platform, Gloss, the new solution offers international transaction settlement and real-time custody and financing services, enabling firms to boost reporting transparency and increase efficiency of operational processes.

Gloss' new capabilities allow prime brokers to offer full settlement services to buy-side investment firms and hedge funds, automating security and currency transaction processing, enabling firms to manage books and records in real-time and facilitating efficient asset servicing. In addition, the solution offers clients global multiple central securities depository (CSD) connectivity. As multi-asset functionality becomes increasingly important in the fund industry, Gloss is well-placed to help prime brokers extend their services, expanding the number of products they can offer and their geographical reach, through a single consolidated platform.

Additionally, in order to provide current insights into the prime brokerage market and its associated IT requirements, Broadridge has sponsored an independent study by the research and consulting firm, Celent, entitled "New Basis for the Hedge Fund/Prime Broker Relationship". The white paper can be accessed via www.broadridge.com/intprime.

Paul Clark, senior strategy and product manager, Securities Processing Solutions, International, Broadridge, said: "As activity and complexity in the fund industry continues to increase and the multi-prime model expands, prime brokers need one technology platform that offers their clients an efficient back/middle office solution. It needs to ensure transparency in reporting and operational efficiency as well as supporting their customers' business growth into new asset classes and markets. The Gloss prime brokerage solution is another step forward in our strategy to offer extended services to our clients on our single multi-asset platform."

Proven in the market, Gloss has a strong pedigree and the new prime brokerage capabilities are already live with one client, a tier-one international investment bank and financial services firm. Available now, worldwide, clients can opt to use the full Gloss suite for multi-asset processing. Alternatively, Broadridge offers discrete services for firms wishing to use specific functional capabilities such as custody. The Gloss solution is available on an ASP service bureau basis, or as an on-site licensed solution.

BNY Mellon enhances automated deal matching for clients

BNY Mellon is introducing a series of enhancements to its automated deal matching service for tri-party repo clients that will allow clients to input, monitor and view trade matching status on a real-time, online basis. The new capabilities will improve risk management practices among market participants.

BNY Mellon's enhancements support the Tri-Party Infrastructure Reform Task Force Recommendations issued in May 2010. BNY Mellon has taken a leadership role in the Task Force's activities and overall reform efforts, serving on a variety of committees and working groups, including as the co-chair of the Operational Arrangements Working Group.

The trade matching service enhancements will allow dealers and cash investors to submit trade details according to 13 standard matching parameters via AccessEdge, BNY Mellon's web portal for tri-party repo clients, or either a SWIFT or proprietary BNY Mellon message format. BNY Mellon will conduct an automated matching process, which will provide dealers and investors with a consolidated view of trade instructions, terms and modifications. In addition to the online functionality, dealers and investors will be able to submit trades and receive updates using real time messaging capabilities or via file formats using industry standard protocols. Vendors can also submit trades in this manner on behalf of market participants.

"By introducing these enhanced capabilities, we will significantly improve the timing, transparency and accuracy of tri-party settlements, which will lead to greater confidence and reduced risk in the market overall," said James Malgieri, CEO of BNY Mellon Broker-Dealer Services.

As part of its efforts to continuously improve its services and meet the recommendation of the Task Force, BNY Mellon recently introduced an auto cash substitution capability for both Fed and DTCC securities that provides dealers with easy access to the securities they need for daily trading. With Auto Collateral Request and Auto Collateral Exchange – two new features on the company's sophisticated technology platform – BNY Mellon retrieves only those securities required for the settlement of trades.

"We are fully focused on providing clients with the tools required to accommodate the new market initiatives while continuing to deliver the operational, reporting and risk capabilities and expertise they have come to expect from BNY Mellon as a market leader," said John Morik, managing director, BNY Mellon Broker-Dealer Services.

Rabobank mandate awarded to BNY Mellon

BNY Mellon Asset Servicing has been appointed by Stichting Rabobank Pensioenfonds (Rabobank Pension Fund) in the Netherlands to provide custody and other services to assets valued at $16.4 billion.

Various asset servicing capabilities, including securities lending, performance and analytics, and execution services are thought to make up this mandate win.

BNY Mellon was selected as it can offer Rabobank Pension Fund a robust offering while ensuring that potential operational risks and any administrative burden is reduced to a minimum.

Frank Froud, head of Europe, Middle East & Africa at BNY Mellon Asset Servicing, said: "Rabobank Pension Fund has a well-deserved reputation for prudence and innovation, and its close cooperation with its strategic partners means it benefits from having a highly effective and risk-averse operating model."

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Portugal

Financial problems have engulfed Portugal, tempering the securities lending market

BEN WILKIE REPORTS

And so the dominos are falling. First Greece, then Ireland and now Portugal. As one of the PIIGS countries, along with Italy and Spain, Portugal has found the financial downturn hard work, with an EU bailout just around the corner.

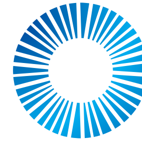
While it would be unfair to describe the country's spending as reckless, Portugal has over the past few years invested heavily in its infrastructure, often through public-private partnerships. As a result, it has institutionalised high levels of public debt, expensive overheads, high upper management costs and a large public sector, which many say is too top heavy and often redundant.

With bond yields rising, the country's credit rating slipped - Moodys reduced its ranking from A1 to A3 and proffered a negative outlook - and a sale of Portuguese debt failed. 10-year bond yields rose over 450bps. In April the inevitable happened, with a request for a financial bailout from the IMF and European Union. The cash injection is worth around 80 billion euros.

As one of the PIIGS countries, along with Italy and Spain, Portugal has found the financial downturn hard work

The political fallout of the crisis has been heavy. The bailout funds don't come for free, and the Government fell after it was heavily criticised both for the high levels of spending leading up to the crisis and its inability to manage the country through its difficulties. With foreign liabilities of 108 per cent, Portugal's external debt is technically worse than that of Greece, although the overall economic situation doesn't appear as bad.

Although Portugal is a modern economy and longstanding member of the EU and the euro, it is not a particularly wealthy country, even at the best of times. It has the lowest GDP per capita in Western Europe and one of the lowest incomes per head of population of the whole European Union. Portuguese attitudes to work-life balance tend to veer to the side of the life, with relatively low incomes. At least for those who have a job - unemployment has hit 10 per



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cent at times over the last year, with graduates and young professionals particularly hard hit. With a heavy reliance on tourism, particularly at the mid to higher end of the market, falling incomes across the rest of Europe has had a further knock on effect.

One of the problems Portugal is facing is really not of its own making. Because the bailout for Greece hasn't quite gone as planned, with the country failing to impose austerity measures, seemingly unable to reduce the amount of tax evasion and having to go begging for further cash, there is a lack of trust from the authorities. This means that the restrictions that come with the funds on offer are tighter than ever. If Greece defaults or comes back for even more money, the pressure will mount further.

And this hasn't proved popular with the Portuguese people. Already struggling with one of the lowest average incomes in Western Europe, they are seeing their salaries drop - if they keep their jobs - and the costs of living rise dramatically, all against a backdrop of reduced public services. There have been demonstrations - albeit nowhere near the scale of those seen in Greece - and the politicians have been demonised. As the cuts continue to bite, the country is braced for further unrest.

This crisis has also had a severe impact on Portugal's domestic banks. Having been effectively shut out of the markets for over a year, they're struggling to get funding and most are relying on the European Central Bank to keep going. Most of the country's larger banks are foreign-owned, which has reduced some of the problems, but with such little confidence in the market, there is a long road back.

Securities lending

Since joining the European Union - and particularly since the introduction of the euro - Portugal's banking system has quickly advanced and is as modern as any in Western Europe. Securities lending operations have long been a part of the Portuguese financial system and new rules, introduced at the turn of the millennium, codified the transactions.

However, the country's pension system almost collapsed in 2007, with liabilities far exceeding revenues. However, root and branch reforms have put the industry on a firmer footing, with increased potential for securities lending.

Public sector pensions will now look at an individual's contribution history to determine pension entitlements, and the country's increasing life expectancy will also be the benchmark when setting retirement ages. The previous system allowed retirees to use their top 10 earnings years to reference their pensions and public employees were able to retire at the age of 60 if they had 35 years of experience under their belts. Consequently, the aging population - consistent with nations across Western Europe - meant there were fewer people working than already in retirement.

The reforms had been expected to move Portugal to a sustainable system, albeit largely by reducing the amount a pensioner receives. It was anticipated last year that following the reforms, as a percentage of their individual earnings, a retiree would receive 54.1 per cent of economywide average earnings, down from 90.1 per cent, according to the OECD.

First pillar pensions were expected to be reduced by 10-20 per cent, causing individuals to turn to occupational schemes and personal savings plans.

But it's been slow going - the cap on the payout levels has not been established and, unsurprisingly for a country with high levels of consumer debt and growing concern about personal finances, low take-up of personal plans. But it's early days, and significant growth is expected over the coming decade.

As the market started to feel the turmoil, short selling restrictions were introduced. In June last year, they were further expanded -the new regulation - 4/2010 - extends the requirement for mandatory reporting of short interest to the CMVM. It replaces rule 4/2008.

Reporting is now applicable to all shares that are admitted to trading on a regulated market or multilateral trading. Previously this only applied to the shares of companies included in the PSI-20.

The threshold for reporting to the CMVM is now 0.20 per cent (previously 0.25 per cent), and disclosure to the market must be made at 0.50 per cent. All increases and decreases in significant short interests exceeding thresholds of 0.1 per cent must also be reported and disclosed.

According to Data Explorers, Portugal recently hinted its 2010 deficit could be worse than the forecast at 7.3 per cent of GDP, which dwarfs the EU target of three per cent. The fund flow scenario is similar to that of Greece. Institutional investors own just under USD 6 billion of Government debt and this is the lowest level over the past year. This is a lower figure than Greek Government debt, given that Greece has already been bailed out.

Like Greece, a couple of near term Portuguese Government bonds have shown strong demand to borrow (3.2 per cent 15 Apr 2011 and 5 per cent 15 Jun 2012).

Meanwhile, in the equity space, there is no sign that funds are covering their short positions in Banco Espirito Santo (ELI:BES), which shows four per cent of its total shares outstanding on loan, representing almost 50 per cent of the available supply.

Meanwhile, in the equity space, there is no sign that funds are covering their short positions in Banco Espirito Santo (ELI:BES), which shows four per cent of its total shares outstanding on loan, representing almost 50 per cent of the available supply.

Banco Comercial Portugues is another equity with diverging sentiment, said Data Explorers' Alex Brog. Short selling rose to eight per cent of all shares earlier this year.

But there remains confidence in the industry. Although restrictions on short selling are likely to remain in place for some time, the levels of activity continue to remain strong. While Portugal has had its problems and lost the confidence of some investors, most are staying in the market and waiting for the tide to turn. **SLT**

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Close control

J.P. Morgan's Joshua Lavender looks at the key metrics firms new to securities lending need to manage if they want to ensure returns at the lowest possible risk

INVESTMENT STRATEGY

At its core, securities lending is an investment overlay strategy. It's an investment product that complements existing investment strategies allowing investors the ability to take a portfolio of idle securities and monetise their intrinsic lending value. The process of lending out these securities affords an investor the opportunity to produce alpha by generating income that can be used to increase portfolio returns or reduce portfolio expenses all while accepting a manageable level of risk. For the global markets, securities lending provides critically needed liquidity in the financial markets, supports a variety of trading strategies, facilitates trade settlements and supports general financing techniques.

Mechanics of a transaction

In a traditional securities lending transaction, securities are lent short-term after provisions such as loan length, collateral type (cash or securities) and rebate rate or fee are agreed to by a lending agent and borrower. When transactions are collateralised with cash, a rebate rate will be negotiated between the lending agent and the borrower. This rebate rate, stated as an interest rate, represents the interest on the borrower's cash collateral that the lending agent agrees to pay back to them at the termination of the loan. In order to generate a yield, the lending agent will invest the cash via a commingled fund or a separate account in short-term fixed income instruments in order to generate a spread above the rebate rate. The difference between the yield on the cash collateral and the rebate rate is the revenue that will be shared between the lender and their lending agent. Consequently, lenders should be aware of the market risk they assume with the investment of the cash collateral.

If securities (eg, fixed income or equities) are accepted as collateral, or there is no cash to invest, a borrowing fee is charged. The fee will be applied against the market value of the securities on-loan and is shared between the lender and their lending agent.

Oversight and monitoring - overview

Lenders should monitor their securities lending programmes to ensure that they are achieving their objectives while staying within the expected risk profile. This monitoring should encompass three areas: lending, collateral and performance. Within each area, various metrics should be reviewed on a periodic basis by individuals whose training is in line with the appropriate oversight task. Oversight can be conducted through reporting, due diligence reviews, and on-going communication with the lending agent.

Tips for better oversight

To facilitate oversight, lenders should obtain information on a variety of metrics including:

- **Borrower exposures**
- **On-loan amounts**
- **Collateralisation levels**
- **Rebate rates**
- **Spreads**
- **Investment portfolio or securities collateral holdings**
- **Earnings**

Oversight - lending

The first area of oversight, lending, focuses on the loan side of the transaction. Specific metrics should be reviewed daily, while others can be done monthly. Lenders should be aware of the counterparties (eg, borrowers) involved in their programme, review the market value of securities on-loan to each, and the proportionate share that each borrower has to their overall programme. Lenders may want to avoid concentration risk by requiring their lending agent to use a diverse universe of borrowers. Since lenders are typically indemnified by their lending agent against borrower default, they need to be com-

fortable that their lending agent has the capital resources available to stand behind the indemnification, and therefore, it's important for lenders to be aware of their lending agent's financial condition. Finally, lenders may find it prudent to aggregate their securities lending borrower exposures with that of other transactional activity (eg, swaps) to determine their overall firm-wide exposure to various counterparties.

Lending oversight tips

In managing your lending, monitor the following:

- **Counterparty exposure**
- **Lending agent's financial strength**
- **Yield on cash collateral vs. rebate rate**
- **Open vs. term loans**
- **Factors that effect rebate rates**
- **Market value of collateral vs. market value of the securities on loan**
- **Securities that are trading "special"**
- **Utilisation rates**
- **Security sale fails as a result of lending**

The vast majority of loans are for an overnight (eg, open) period, meaning they can be terminated on any day and the rebate rate can be negotiated daily, when the transaction is secured by cash collateral. When loan transactions are collateralised by cash, lenders should compare the yield earned on the cash collateral against their loans' overall rebate rate in order to gauge the profitability of their programme.

Generally speaking, loans are overcollateralised at either 102 per cent for same currency transactions or 105 per cent for cross currency transactions. As such, lending agents mark-to-market the collateral daily after the financial markets close to determine if additional collateral is required from the borrowers or if collateral needs to be returned.

Lenders may want to avoid concentration risk by requiring their lending agent to use a diverse universe of borrowers

To further gain an understanding of the supply/demand dynamics of their lendable assets, lenders should periodically evaluate their utilisation rates (eg, programme-wide and security type) to determine how much of their portfolio is out on-loan. With this information, lenders can assess the overall risk/reward profile of their lending programme. For example, fewer loans with higher fees or wider spreads imply a high degree of "specials" (eg, high borrowing demand) allowing for a lower risk/higher return programme or a very efficient loan distribution.

Lending securities should be largely transparent to the lender's portfolio management process and it should not impede an investment manager's trading ability. On occasion however, a security that was out on loan and subsequently sold by the lender may fail to be delivered on settlement date. Failure to return securities on time may be caused by a combination of lower liquidity and high borrowing demand or a sale instruction received past an agreed upon deadline. Under most circumstances, large securities lending agents may be able to execute a loan swap thereby substituting the loan with another lender to avoid the fail. If this option is not possible when sale instructions were received on-time and the lending agent provides contractual settlement, lenders will be advanced the sale proceeds on settlement date and the borrower will be penalised by not being entitled to share in the earnings from the investment of the cash collateral from the fail date forward. In those cases where a security sale fails as a result of lending, the lending agent should provide a detailed analysis of the underlying cause and propose a resolution strategy. Actively reviewing the metrics of securities on-loan provides a lender with the necessary tools to adequately assess exposures to various counterparties, borrower demand, and the overall intrinsic value of their portfolio.

Tips for monitoring your programme

As a lender you should work with your lending agent to understand the factors that affect rebate rates and be aware of the proportionate share of open vs. term loans to determine how interest rate changes will impact your programme's return.

Monitor the market value of the collateral vs. the market value of the securities on-loan on a daily basis to make certain that the collateralisation of the loaned securities remains at a sufficiently protective level.

On a daily basis, inform your investment managers of securities that are trading "special" since it may provide them with additional market colour.

Oversight - collateral

The second area of oversight involves the review of the collateral. As previously mentioned, securities lending transactions are either collateralised with cash or securities. In either case, it's incumbent upon lenders to know whether their lending agent indemnifies them in the event of a borrower default to protect against the risk that the value of the securities or cash collateral delivered to the lending agent is not sufficient to cover the return of the collateral to the borrowers at the end of the loan, or in the unlikely event of a borrower default.

Overseeing the cash collateral in a securities lending programme should encompass a similar process to that of any short duration fixed income mandate

Cash, which is typically used to collateralise a loan transaction in the United States, is invested in short-term fixed income securities, adding a layer of investment risk to the lender. Therefore, it's prudent to have an individual with fixed income investment experience involved in the monitoring process. In addition, it's imperative that lenders have documented, well defined and transparent cash collateral investment guidelines. Overseeing the cash collateral in a securities lending programme should encompass a similar process to that of any short duration fixed income mandate. Essentially, when cash collateral is involved, a lender takes on the risks from the investments such as interest rate, credit, duration and liquidity risk, and therefore having input from individuals familiar with such risks is recommended.

Market events that can affect your securities lending programme when cash collateral is accepted:

- **Federal Reserve eases or tightens rates**
- **Credit spreads widen or contract**
- **The yield curve inverts, flattens or steepens**
- **Short term interest rates such as LIBOR rise or fall**

As financial market conditions change, lenders should work closely with their lending agent to be aware of the affect of these changes on their programme and anticipate the impact of market events. An understanding of how these events or actions can affect or influence a programme's profitability and performance is critical in order to assess whether a mandate is positioned appropriately to be in-line with its expected risk and return.

At the very least, lenders and their lending agent should discuss on a periodic basis the cash collateral investment strategy, investments held and overall programme philosophy. As a starting point, a lending agent should provide an indication or estimate of the expected return from the investment of the cash collateral vs. the de-

mand to borrow securities while lenders should assess whether this estimate is in line with their risk/return profile. Lenders need to have a clear understanding of their program's cash collateral investment guidelines with respect to such attributes as security types, duration, sectors, issuer concentration, liquidity levels, proportionate share of fixed vs. floating rate securities, and credit ratings.

When securities (eg, not cash) are used to collateralise a loan transaction, if the lending agent does indemnify against borrower default, then a lender's exposure to their lending agent is increased. Knowing the types of securities utilised to collateralise their loans and whether or not indemnification is provided against a short fall in the value of the collateral, will help lenders discern how much if any of their lendable portfolio's risk profile has been altered and therefore, how their portfolio might be impacted by market movements or events. Effectively, if one security type is loaned out to a borrower and collateralised with another security type, a mismatch scenario would ensue and the risk profile of the lender's portfolio could be altered. Consequently, it's important to be aware of any correlations between security types.

Collateral tips

Review the following in managing your collateral:

- **Cash collateral investment strategy**
- **Securities purchased with cash collateral**
- **Programme philosophy**
- **Investment guidelines**
- **Securities collateral**

Oversight – programme performance

The last area of oversight involves the assessment of the overall program's performance with respect to investment return, core drivers, and the associated risks taken. It's not enough to focus solely on earnings; a lender should seek a clear understanding of how those earnings were achieved.

Programme performance focuses on reviewing:

- **Investment return**
- **Core drivers**
- **Risk taken**

Earnings can be derived from two places – the demand to borrow securities and the investment of the cash collateral. Assessing the performance of a program that accepts cash collateral encompasses a variety of metrics. First, lenders need to be aware of three types of spreads – gross, demand and investment. The investment spread is the yield the lender earns on the invested cash collateral less a risk free rate (generally viewed as the overnight Fed Funds rate) and the demand spread is the difference between the risk free rate and the rebate paid back to the borrower. The combination of the two spreads equates to the gross spread. Wider investment spreads may indicate a greater assumption of investment risk, and similar to any other investment strategy, this risk is borne by the lender. Therefore investment guidelines should reflect the lender's risk/return profile.

Effectively, if one security type is loaned out to a borrower and collateralised with another security type, a mismatch scenario would ensue and the risk profile of the lender's portfolio could be altered

An important metric that lenders should understand is the maturity gap. The maturity gap measures the difference in duration between a lender's assets (eg, cash collateral investment portfolio) and liabilities (eg, loan portfolio). Generally speaking, a wider maturity gap increases a lender's interest and duration risks but can lead to greater earnings as one moves further out on an upward sloping yield curve allowing a lender to take advantage of higher interest rates. Familiarity with the projected direction of interest rates, expected changes to the slope of the yield curve and an understanding of the proportionate share of fixed vs. floating rate investments will help a lender ascertain the level of risk their securities lending agent is taking in managing the maturity gap risk.

Performance metrics

In assessing the performance of a programme that accepts cash collateral the lender must understand the following metrics:

- **Gross spread**
- **Demand spread**
- **Investment spread**
- **Maturity gap**

Looking at trends and discovering the core drivers behind a programme's results is an important oversight tool for lenders. Reviewing results and trends of various metrics such as earnings, utilisation rates, spreads, and the maturity gap will allow lenders to ask questions about their programme's performance. Lenders will gain a better understanding of how changes in borrower demand and interest rates along with market activity effect their results and will help set future expectations.

Core drivers of programme results:

As lenders assess their programme's various metrics, they should be aware of the core drivers behind these results. Examples include:

- **Changes in the Fed Funds rate**
- **Fluctuations in borrowing demand**
- **Increased/decreased market volatility**
- **High number of "specials" securities**
- **Increased/decreased lending of less liquid securities such as small cap equities and high yield bonds**
- **Lending international dividend paying equities during a specific time of year**

Depending on a lender's resources and the overall sophistication of their programme, more extensive due diligence reviews should be conducted with their lending agent on a quarterly or semi-annual basis to discuss in greater detail the market environment, performance results and attribution and the agent's overall programme as well.

Summary

Proper oversight is about education, monitoring and goals. Having a thorough understanding of securities lending, performing on-going monitoring of the key metrics behind your programme and having a defined set of goals with respect to lending motives and risk/return parameters will provide the framework for proper oversight.

Today, securities lending continues to present an attractive opportunity for investors to generate additional alpha or income within a risk controlled environment. Utilising a disciplined oversight approach, this investment strategy allows lenders to benefit from enhanced portfolio returns and lower operational expenses while remaining transparent to the portfolio management process. On-going oversight by an appropriate set of professionals enables lenders to gain a better understanding and appreciation of the risk/return dynamics in their programme. **SLT**

Joshua Lavender
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European securities lending

With ISLA's annual conference upon us, we gathered leading figures in the industry to discuss the state of the market and where the growth will be found

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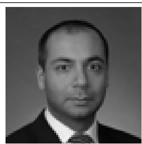

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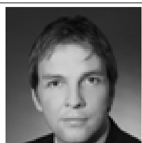

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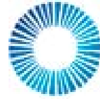
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STATE STREET

How would you describe the past year for European securities lending?

Reeve Serman: So far so good. The year has been fairly positive to date with a healthy mix of seasonal demand, script trade opportunities and a trickle of specials. Traditional seasonal demand in European trade activity helped the first half of year as the market experienced a high level of interest from the borrower network in most primary European markets, as well as the Scandinavian markets. The seasonal demand did peak earlier in the first quarter in comparison to previous years. There is also a clear trend of shorter term trades due to higher costs of collateral as well as capital constraints which make borrowers more selective and strategic with the use of their capital. Markets like Switzerland were somewhat disappointing as they fell out of favour with most participants. Challenges in Switzerland became evident as many financial institutions paid dividends this year as a return of capital, which squashed the demand side of the trade.

Merger and acquisition activity in Europe began to reemerge in the first half of the year but the pace of recovery remains slow with a small uptick in special opportunities. We also experienced very strong demand for UK and Dutch script trades from multiple market participants.

Sunil Daswani: We have seen returns in the European securities lending industry nearly return to pre-crisis levels. With borrower continuing to experience various pressures including balance sheet constraints, demand has remained subdued over the past 12 months.

We also continue to see our European supply return to the industry following the market events of late-2008. While we are unlikely to see a return to the peak loan volume levels of early-2008 anytime soon, confidence continues to return to the market.

Jemma Finglas: Seasonal revenues, associated with the European equity business, for the most part have improved by some 15-20 per cent, year on year.

This is due to a combination of increased demand from borrowers and higher dividend payments.

However, there have been specific challenges in the German and Italian markets, which will have a permanent impact on the future earning potential in these markets.

The flow business continues to migrate onto the main trading platforms and this automation is a welcome enhancement to the industry.

Despite the significant level of automation, transparency and partnership remain key elements in managing both lending and borrowing relationships with regards to more complex and profitable trades.

From a fixed income perspective, Basel III capital requirements will continue to have an impact on GC business. There is a noticeable move toward the very lucrative term commitment trades.

The cost of capital, regulation, risk, collateral and demand are all key areas of consideration for clients and providers alike.

Uncertainty in all of these areas coupled with lack of growth in the global economies means activity has been and will continue to remain constrained.

> Serman: There is also a clear trend of shorter term trades due to higher costs of collateral as well as capital constraints which make borrowers more selective and strategic with the use of their capital

Rory Zirpolo: The past year in European securities lending has largely been event driven, with activity – both in terms of the market value of on loan shares and their cost to borrow – being highest around the periods of greatest concern over sovereign financial stability. Collateral management concerns further contribute to depressed volumes. Firms remain focused on optimising its collateral management decisions and other cost efficiencies.

Paul Wilson: The past year has been quite positive. We have seen healthy growth in our business, driven by new custody and third party clients. These include clients lending for the first time, as well as a gradual increase in demand. We continue to see our clients review lending parameters and willing to relax some of their restrictions and guidelines imposed at the height of the market crisis.

Rob Coxon: It has certainly been a strong year for BNY Mellon. Revenue derived from European securities, especially equities, remains a major contributor to our clients' overall securities lending revenues. European companies have had good earnings, which has resulted in improved dividend yields, and there has been an increase in M&A activity and "specials" overall, and that has made for a good 12 months. That said, the Euro fixed income side has seen its ups and downs, especially with Euro Overnight Index Average (EOINA) being so volatile, which impacts those clients accepting Euro cash collateral. Looking at the big picture, if there is a challenge it is a lack of demand as opposed to supply, which is back to pre-crisis levels; our inventory is broad and deep. However, until demand does rebound, we will continue to see pressure on prices and rates.

Overall, clients seem to have confidence in how the market is operating today. They do remain sensitive to counterparty risk and over the past year they have certainly put their programmes under considerable scrutiny. Individual clients obviously have their own specific appetite for risk, and some are setting a minimum spread hurdle, while others are looking to generate returns from a spread of assets or are primarily focused on exclusives. Broadly speaking clients, as already noted, are expanding their non-cash guidelines to include equities – G10 sovereign debt has become more expensive and clients also now recognise that, post-Lehman, those holding equities as collateral did not have any losses.

We have also seen a refocusing on the intrinsic value of the securities lent among those more risk-averse lender, who are focusing on securities with the largest spread and so are looking to us for in-demand specials as opposed to general collateral .

Nick Bonn: The European securities lending landscape continues to be highly focused on potential future regulatory changes. Supply and demand are growing as a result of two main factors: clients that had suspended activity are re-entering and fine tuning their goals and requirements and many new clients are signing up to our agency programme. Intrinsic value lending has always been a cornerstone of our programme, and the low interest rate environment presents challenges, particularly in relation to the yields obtainable on cash collateral reinvestment. In an attempt to mitigate the reduced yields available from cash collateral reinvestment, we have seen a significant increase in non-cash collateral demand. The changing regulatory and capital environments underscore the need for agent lenders to be able to provide bespoke solutions

to the growing challenges faced by clients within the various financing models. This is an area where State Street continues to excel by assisting our clients in meeting requirements, specifically as regulatory changes unfold. Our clients continue to recognise this expertise as the true value differentiator for us.

Arne Theia: Last year was very difficult and for many securities lending desks disappointing. And it still is. That's because the market environment is changing so much. Apart from new upcoming regulations people most worry about missing demand. Traditional drivers of securities lending have become less important or even may disappear. Reasons are deleveraging, less proprietary trading, short selling prejudice or tax harmonisation. Also most of the hedge funds are currently more long than short.

> Theia: Traditional drivers of securities lending have become less important or even may disappear. Reasons are deleveraging, less proprietary trading, short selling prejudice or tax harmonisation

Simon Lee: When evaluating beneficial owner behaviour one would argue that we are moving in a positive direction, albeit cautiously. In the two years following the Lehman default, lenders were solely focused on addressing the risks in their programmes. Today, there are now more beneficial owners looking at the performance of their programmes, as evidenced by the fact that they are expanding mandates, issuing RFPs, and in some cases changing providers. However, to put this positive momentum into context, we have to recognise that volumes remain below the highs of 2008.

Kevin McNulty: My perspective comes from not being in the business directly but from my dealings with our member firms. Since the height of the crisis, most lenders seem happy to be in the market but there is little appetite to accept much additional risk with collateral profiles remaining quite conservative. Volumes are clearly down on where things stood but things appear to have stabilised. I think agent lenders deserve credit for spending time educating their beneficial owner clients on the business and this has resulted in healthy supply levels. On the demand side, whilst the hedge fund industry is looking reasonably healthy in terms of assets under management, this isn't driving much growth in short selling.

Is the European securities lending market as important as ever, or are people more keen now on Asia or even South America?

Daswani: European assets continue to be as important, if not more so, than those of Asia or South America, not least because over the past several years the returns on European portfolios have continued to outpace those competitor regions.

While some Asian or South American portfolios have indeed generated significant returns, European securities continue to play critical role in investors' asset allocation strategy, which will mean the European securities lending industry will maintain its importance in the near-term.

However, we are mindful that Asia's proportion of global securities lending activity is steadily increasing, and all European participants, including regulators, will need to work together over the long term to maintain market share.

Finglas: European markets remain an important source of revenue for the industry. However, in terms of growth potential and regulation the former is the antithesis of the Asian and South American markets. As a mature and well-established marketplace, all eyes from the developing markets will be watching the European regulators. How they deal with the current challenges will be instrumental in determining the future level of importance of these markets in our industry.

In terms of regulation the Hong Kong market specifically, is often held up as an example of how an efficient market should operate. HK regulators seem to have managed the demand on reporting and settlement with a level of practicality that currently eludes the European proposals.

It is true that with regards to structure the Brazilian and Taiwanese markets are often described as "lending with brakes on" as they are restricted somewhat in terms of where collateral is held (ie, at the CCP). However, it is also true that there a number of different products available with which to access the market and so activity in the market place is not as restrained as first perceived.

From a global perspective, the potential drag on demand that higher capital levels and increased regulation will place on international institutions cannot yet be determined.

Whilst there is a definitive shift in interest, we believe this would be even more pronounced if demand in general was stronger.

McNulty: Most participants view the business as global and look for opportunities to grow their businesses across all the regions. Whilst I hear that a lot of firms are focusing attention on areas of potential growth, including lending returns in Asia and South America, they still have a core business in Europe. There are also potential future opportunities in Russia and the Middle East.

Zirpolo: Europe continues to be an important region to securities lending because of its size and depth of liquidity. However developing markets, where securities lending has recently begun, are gaining importance.

> Daswani: We are mindful that Asia's proportion of global securities lending activity is steadily increasing, and all European participants, including regulators, will need to work together over the long term to maintain market share

Wilson: Europe remains very important, due to the size of many European clients and institutions as well as the demand to borrow European assets. We have seen substantial growth globally, whether it be Europe, Asia or Latin America. This past May, J.P. Morgan became the first non-domestic agent lender to lend in Brazil. J. P. Morgan's global footprint allows us to see opportunities in all quarters.

Serman: European securities lending will always be an important market segment in both the equity and fixed income space. New regulations on capital and liquidity rules are creating opportunities as there is increased demand for high quality government debt in both the overnight market as well as an increased demand

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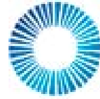

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for term structures. We believe M&A, corporate actions, and seasonal demand activity will continue to be a source of opportunity on the equity desk for the foreseeable future.

The globalisation of assets and securities lending is also following this trend. Along with Asia, South America cultivates optimism amongst the financial community for long-term growth. Brazil remains at the forefront of a number of other territories expecting to develop and make the region a prime location with a diverse range of opportunities.

There has been tremendous progress in other developing countries both in Asia and South America that are looking to implement positive changes to their existing securities lending structures. Countries like Taiwan and India have amended their legal, securities and tax regulations to allow for a more robust securities lending market.

Demand in India has not yet triggered massive interest at this point although we continue to watch that space. In China, the perception for opportunity is not will there be opportunity, but when. When the regulatory changes do come, they will require considerable guidance, interpretation and clarity from the policymakers involved. As a result, proper due diligence and risk assessment is a critical factor before entering a new market and before one can capitalise on any of these opportunities.

Coxon: Due to its primacy as an ongoing source of revenue generation, yes, the European securities lending market continues to be important, not least for those clients or funds that have significant asset allocation across the region. While it is true that Europe's maturity means that certain types of trade have become commoditised, there is significant revenue to be generated due to the sheer volume of transactions. Certainly, people will always be keen on the more esoteric markets found in Asia and South America due to the high spreads these markets command – but the securities lending revenue potential will be somewhat limited compared to Western European markets given their lower market capitalisation.

Bonn: There continues to be significant interest in select Asian and South American markets. Hong Kong, with its connections to China and Taiwan, are examples where good lending opportunities exist. In South America, Brazil is arguably demanding the most focus. However, Europe remains a key securities lending market for us and one in which we continue to see a healthy pipeline in both traditional and new markets. The strong flow of M&A activity, capital raising by financial institutions, and capital raising to fund acquisitions are frequent occurrences, all of which is good news for the European business.

Lee: The European lending market does remain as important as ever, and for market participants in the region, Europe remains a primary source of securities lending income. Similarly, the Asian securities lending markets have always been important to firms located both in and outside of the region, and over the last year individual markets such as Hong Kong have provided increased returns for lenders. South America is receiving increased attention at present due to the interest in the Brazilian securities lending market. There are some lucrative opportunities on which to capitalise for early entrants in Brazil although this limited activity in one market does not translate to an entire region.

How have the sovereign debt crises in Europe affected securities lending activities?

Theia: For me the most significant change during the financial market crises was the transition from unsecured to secured financing. Hence secured products like repos and securities lending have become very important to solve funding problems of banks and their customers specifically in Europe. Emerging markets have become important because of their tremendous growth potential. In Asia most people focus on China and India. In South America I see a lot of activities in Brazil. But also Argentina is back after its financial collapse in 2002. Biggest hurdles in these markets are missing robust legal frameworks and missing infrastructure and regulation.

Bonn: We've generally seen a flight to quality as a result of these crises, with French and German govies regarded as a home for risk-averse investors. Importantly, the current sovereign debt crises are also giving rise to opportunities. The widening spread between core eurozone and peripheral countries has created lending opportunities, including spread trades involving lending core eurozone debt versus non-core debt. The sell-off of peripheral debt has also led to some specials where we've seen significant spreads, as in the case of the Greek 10-year. Although nothing is trading to the extremes we saw last year and volumes are somewhat thin, there are still numerous specials across Greece, Portugal, Ireland and, to a limited degree, Italy.

Serman: The European debt crisis has caused most investors and agent lenders to scale back their credit exposures mostly to European (PIIGS) countries that are directly and currently embroiled in the crisis. Capital and liquidity requirements dictated by various European regulators have created an increased demand for high quality Sovereign European Debt such as UK Gilts and German Bunds as well as other select OECD countries. The prolonged period of turmoil and lack of alignment among European regulators to deal conclusively with the issues has not hastened the recovery and volatility remains a constant factor that one has to watch closely.

Bonn: We've generally seen a flight to quality as a result of these crises, with French and German govies regarded as a home for risk-averse investors.

Daswani: We have certainly seen both the demand and fees for European sovereign bonds in the securities lending market impacted by the sovereign debt crisis over the last 18 months.

At one end of the risk spectrum, strong levels of demand from borrowers have driven up the lending fees for a number of Government bonds in the "peripherals", that is Portugal, Italy, Ireland, Greece and Spain. The demand has been prompted by the on-going headlines and rating agency downgrades for these countries that have generated high levels of price directional trading.

Simultaneously Germany, the undeniable stalwart of Europe, has experienced a "flight to quality" as investors requiring Euro currency exposure have purchased their Government bonds. This increased demand from investors reduces the levels of liquidity in the market place, driving lending demand from borrowers.

Finally, over the last 18 months we have seen high levels of volatility in EONIA, the traditional reinvestment benchmark for Euro cash collateral. This has been driven by the credit spreads between the Euro Sovereign nations widening and the ECB's on-going liquidity management programme.

Finglas: The political and regulatory ramifications have been far reaching and have culminated in the Commission Proposals (Sept 2010)

which are currently under discussion and debate. As a result of the uncertainty surrounding the proposal, flow business in sovereign debt is considerably lighter than ever before. Lucrative fixed income term trades, in place due to other regulatory pressures, are the main cause of high utilisation rates.

Zirpolo: In addition to depressing volumes, Europe's debt crises have weakened the credit quality of non-cash collateral being posted to finance securities lending transactions. This will be an area of continuing concern as the crises persist.

> Coxon: The sovereign debt had no real discernible impact on our programme – we simply removed the specific countries in distress from the eligible collateral pool as soon as they received a collateral downgrade

Wilson: The sovereign debt crisis has had a minimal impact. Balances have remained solid and client interest strong, apart from some short term volatility as the market reacts to changing news and events. We keep a watchful eye on the volatility in short term EONIA rates. And we have positioned client re-investment portfolios appropriately to not be impacted.

Coxon: The sovereign debt had no real discernible impact on our programme – we simply removed the specific countries in distress from the eligible collateral pool as soon as they received a collateral downgrade. Aside from a few 'specials' in Greek and Portuguese bonds, our European Fixed Income programme remains unaffected as it largely centres around the lending of French OATs and German Bunds.

Theia: The European market has definitely become more fragmented. There are strong banks and weaker banks. High quality and low quality collateral. Liquid and illiquid secondary markets. Certain government bonds are not accepted any more as collateral. Also correlation risk between sovereign debt and counterparty of the same origin within the Euro zone is emerged. We are also facing short selling regulations on EU sovereign dept and EU shares, which reduces securities lending activities.

McNulty: I won't comment on the trading aspects of this, but an indirect affect has been the attention by regulators on the use of CDS and this has been picked up by the European Parliament who propose banning the use of naked sovereign CDS in the short selling regulations. Unfortunately this has rather distracted attention away from the other core elements of the short selling proposals which I'll come back to.

What are your thoughts on the proposed EU legislation on short selling?

McNulty: I have quite a lot of thoughts on this! I'd start by saying that the case for regulating short selling in the first place is actually not that strong. The reality is however that we are going to get some pan European regulations shortly. At the time of writing it is not completely clear what the regulations will actually cover as there are differences of opinion amongst the legislators. The political focus has turned to whether or not naked CDS should be banned but the issues for the equity and bond markets remain crucial. The three most important issues for us concern public disclosure provisions, the definition of uncovered (naked) short positions, and the treatment of sales of lent securities. The provisions for these three issues remain in the balance and we continue to push for anonymous public reporting of positions, a definition of covered short selling that requires the seller to have a reasonable expectation of being able to cover the sale (as opposed to having to reserve shares ahead of time), and clarity that a sale of a lent security will not be treated as a short sale.

Coxon: Our position is the same as ISLA's. We believe in improving transparency for both investors and regulators. My concerns are not around having a short covered – that already happens, it is established market practice and whether or not you formalise that is a matter of personal choice – but rather around the public disclosure requirements. At 0.5 per cent they are too onerous and will inevitably have a negative impact on the volume of business done by hedge funds or the amount of level trading activity they commit to in a specific play – and that will of course knock through into overall securities lending demand. As I've said before, that is frankly disappointing. Plus, equal treatment of long positions and short positions in terms of reporting also seems like simple common sense.

Serman: The public disclosure of investors' portfolio positions will not necessarily improve market discipline. In fact, it could have the opposite effect where some investors may withdraw completely from markets thus negatively impacting liquidity and limiting market enthusiasm. There are several studies conducted by international associations, including the International Association of Securities Commissions (IOSCO) and independent consultancies, highlighting the risks and practices adopted in non-EU jurisdictions like Japan and Hong Kong.

Increased disclosure of investment activities to regulators, however, (including short selling) combined with improved dialogue between investors and other market stakeholders will alleviate uninformed knee-jerk reactions when financial instability ensues.

Daswani: Clearly the final shape of the regulations will not be known until the end of the trialogue process between the EU Council, Parliament and Commission. We are still hopeful that the final outcome will provide a coherent and proportionate regime that will allow short sentiment to continue to provide its vital functions of price discovery and the mitigating asset valuation bubbles.

> McNulty: The reality is however that we are going to get some pan European regulations shortly. At the time of writing it is not completely clear what the regulations will actually cover as there are differences of opinion amongst the legislators

Finglas: The intention of the proposed legislation is to harmonise requirements relating to short selling and the powers afforded to regulators. The aim is to identify risks without unduly detracting from the benefits that short selling provides. These facts alone are testament to how far the regulators have come in understanding two points; the first being that short selling is not synonymous with abusive trading strategies and the second that there are significant benefits afforded to market efficiency and liquidity through short selling.

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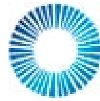
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However, the proposal presumes that there are undefined "other risks" which might arise from short selling and that these risks need management. It assumes that increased regulation will increase the efficiency of the markets and it gives powers to a centralised body (ESMA - European Securities and Markets Authority), which will in turn manage and ensure correct enforceability of the local "competent authorities".

Parameters are not clearly defined, nor is it clear how monitoring and implementation could be achieved in a consistent manner across all market participants. Until greater clarity is achieved any legislation will be difficult to achieve.

Zirpolo: The move to require public disclosure of large short positions is a positive step to gaining transparency in broader equity markets and can generally be viewed as favourable

Zirpolo: EU legislation seems to be largely without teeth because despite banning naked short selling (which some might view as predatory), it does little to impact the CDS market (a market in which some could draw similar conclusions about predatory trading). The move to require public disclosure of large short positions is a positive step to gaining transparency in broader equity markets and can generally be viewed as favourable.

Wilson: One of the challenges with this legislation is three bodies, the European Parliament, European Commission and European Council are reviewing this law and have to reconcile into one set of common rules. The key issues all three bodies need to agree upon include: making public disclosure of short positions anonymous, agreeing to a 'soft locate' regime and include wording that confirms a lender, selling a position on loan, is not executing a short sale.

Bonn: This legislation could have a significant impact on the industry. Currently, different stances are taken by the Council and the Commission on several aspects of the regulation. However, independent from the final wording, the European short selling regulation is likely to have an impact on how the industry conducts its business and its functioning more generally. Not only will the industry have to consider how it operates should a "hard" locate and reserve requirement be implemented, but more importantly, such a rule could have a negative impact on market liquidity. The locate rule is one particular example of where a difference of opinion exists between the Council, who favour a "soft" approach, and Parliament who are advocating the "hard" rule. In addition, unless it is sufficiently clarified, a significant impact on markets and the industry could result from the definition of a short sale. Essentially, the industry is seeking clarity that the sale of a lent stock by a beneficial owner or investment manager does not constitute a short sale. While there is general agreement and support for this position in EU circles, it has not yet materialised in the draft legislation. The consequence of not getting clarity could be a significant constriction of supply from underlying lenders not wanting to risk and unintentional breach of the short selling rules with, again, a very significant impact on market liquidity, coupled with a significant reduction in performance of investments.

Theia: The market generally welcomes regulations on naked shorts. But it looks like there is a big confusion about the definition of covered and naked shorts. Or in other words what's regulated and what's not. The level of uncertainty is still high and that prevents a lot of market participants from trading strategic positions, which is bad for the market. Proposed EU legislation has been criticised because the regulation is only for banks supervised by the ESMA. That means there is no regulation for non banks like hedge funds. Also there are exemptions, for example, for market making and primary market operations. Therefore many people say that the new legislation is a law without teeth. In my opinion there are generally only few naked shorts in the market as most short positions are covered at the value date of a trade anyway.

Do you think that in general European countries would benefit from a harmonised regulatory system?

Wilson: Yes, of course. The regulatory framework is already challenging because of all the proposals, be they EU or US driven. Consistency would make life easier for pan-European and non-European entities to navigate their way across the regulatory landscape.

Coxon: Most people would agree that industry participants and customers can only benefit from a properly harmonised regulatory system, not least in respect of transparency. Europe obviously remains a fragmented marketplace, and a fully aligned pan-European regulatory regime, underpinned by a harmonised settlement model, would ultimately reduce risk as well as operational costs for the financial institutions and investors alike.

Bonn: A possible benefit could be in relation to the previous question relating to short-selling. A harmonised European regulatory regime would arguably be a good thing as it would remove the somewhat piecemeal restrictions and interpretations imposed by individual jurisdictions. However, this is subject to the condition that a workable outcome is achieved that does not negatively impact market liquidity and the smooth functioning of financial markets. In general, however, the question between whether to follow a maximum harmonisation or flexibility for national implementation approach will have to be carefully considered and answered on a case by case basis given that there are certain areas of regulation where flexibility for national implementation is required in order to take into account well-established local market needs and practices.

The scope and role of the newly formed European Supervisory Authorities (ESAs) in European regulation and how they interact with individual countries' regulators could represent real progress in European regulatory harmonisation and towards a single European rulebook in certain areas. In this regard, it will be interesting how the ESAs will evolve and how things develop in the coming months.

Wilson: One of the challenges with this legislation is three bodies, the European Parliament, European Commission and European Council are reviewing this law and have to reconcile into one set of common rules

McNulty: Nearly everybody likes the idea of harmonised regulation and there is a strong political will in Europe to try and achieve this. The problem of course is getting it done and just get-

ting agreement on a single issue like the regulation of short selling is proving painful. There is talk of a single European rule book and I suspect that we'll see slow progress in achieving this. From a market participant's perspective, harmonised rules are great (with one caveat) as compliance with fewer rules is simpler and less costly. The caveat however is that the rules are sensible and don't unnecessarily restrict good business. Harmonised bad regulations are clearly not good.

Finglas: The current proposals may yet be pushed through but owing to the lack of support they are already receiving, it would appear their adoption and effectiveness will be compromised

Serman: A harmonised regulatory system would benefit European countries, Regulators and market participants as the infrastructure costs and risks would be greatly minimised. However, this will not become a reality without overcoming some significant hurdles. During the crisis, we witnessed the negative impact of certain jurisdictions adopting rules to supposedly protect their institutions and markets from meltdown without fully comprehending the extensive negative implications of efforts that were not mutually aligned. The impact on liquidity would be one good example. One of the biggest benefits would be to have a more educated and centralised regulatory body overseeing market participants and related risks across a single market.

Some of the objectives that regulators should try to accomplish are centralised regulation, increased transparency, prudent rules around liquidity to ensure markets operate efficiently, as well as coming down hard on abusive market practices.

Daswani: Generally yes but that does imply that each home state has the same market infrastructure, participants and challenges and we are clearly not in that position. I can therefore sympathise with the various home state regulators who are looking to ensure that they apply a level of discretion in their own markets and not be simply become a local monitoring arm of the European Securities and Markets Authority (ESMA).

Finglas: The inevitable harmonisation of the regulatory systems across the board makes sense in the long term from an efficiency and transparency perspective.

How that is implemented and agreed upon is of course the key to its success.

Implementation will be costly and therefore not welcomed by participants who are already stretched in terms of resources, capital requirements, system and disclosure costs.

The current proposals may yet be pushed through but owing to the lack of support they are already receiving, it would appear their adoption and effectiveness will be compromised.

Zirpolo: Harmonising regulation across Europe in securities lending should be a down-the-road concern, as there are far bigger market segments in Europe that still aren't harmonised (sovereign debt, for one).

Theia: Harmonisation is key to have equal opportunities for everyone in the financial markets. In Europe many regulatory implementations are on the discretion of the national authorities. Different regulations in EU countries could lead to regulatory arbitrage. But harmonisation is a global issue. The US is demanding strict regulations in Europe but hasn't implemented Basel II so far.

Lee: One could envisage certain benefits from a standardised regulatory approach to securities lending across Europe, particularly as it relates to increasing transparency for investors – which in turn increases investor understanding of the business and increased investor confidence. Importantly though, any perceived benefits would be lost through onerous or restrictive regulation.

Are there too many CCPs in Europe?

Frank Gast: No, as far as I am aware, there are only two clearing houses in Europe which currently offer a CCP service for securities lending: LCH.Clearnet and x-Clear. Eurex Clearing, for example, is planning to introduce a CCP for securities lending for the OTC market by the end of 2011, so bilateral trades will be cleared through a CCP. Eurex Repo is planning to introduce this service for our SecLend market for Q2 2012 but with a step-wise approach and therefore a limited scope, perhaps for UK, German and Swiss blue chips and European government bonds. Handling equities for example, having dividend payments, having substitutions, re-use, income and non-income events is increasing the complexity of securities lending transactions in a CCP which can be handled as shown in our recently launched GC Pooling Equity market.

On the other hand, the bilateral market still accounts for the majority of trades. The latest ICMA repo survey found that approximately one third is cleared via a CCP, so 70 per cent is still bilateral or tri-party. On the other hand, electronic markets with CCPs are gaining more importance where, for example, zero capital rates are applied at the moment. This might increase to two per cent under Basel III. However, the overall capital cost between CCP cleared transactions and OTC transactions will remain significant. I agree that this may push the market further into the direction Arne mentioned.

However, there is still a lot of uncertainty in the industry throughout Europe over how to treat a CCP within banks, particularly in the audit and risk departments. Based on our experience, this may have an impact on the funding capabilities of some banks. Europe-wide rules for the CCP would certainly improve this situation.

Theia: Regulators promote CCPs because of risk mitigation and transparency reasons. So they will become part of our business. But standardisation is needed. Europe is not mainstream

Theia: Regulators promote CCPs because of risk mitigation and transparency reasons. So they will become part of our business. But standardisation is needed. Europe is not mainstream. It's fragmented and complex. There is a large number of markets with many counterparts in different legal jurisdictions. CCPs in the US for example are very standardised.

Serman: From an equity securities lending perspective, there are not currently too many securities lending related CCPs in Europe. We

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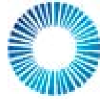

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do not see the core securities lending markets engaging CCPs in any significant way in the immediate term as market participants are not aligned as to the vision of how the CCP should operate. All market participants however should continue to watch this space closely as market participants continue to develop the vision. Rules of engagement would have to be agreed by most market participants to ensure it is a creditable operating structure from a credit risk, legal, and operational perspective and can be 'sold' to parties with a vested interest, including beneficial owners, lenders, borrowers and of course regulators.

Fingals: Transparency has become the focus of the lending clients' attention since the crisis and we do not foresee a change in this approach from their perspective

One school of thought is that there is space for a related securities lending CCP in the marketplace but not as the sole participant, rather as an optional trading vehicle where one could chose to deal with the CCP as well as retain the option of trading with other non-CCP counterparties. This would ultimately be at the discretion of the beneficial owners, who ultimately would need to approve the option of their lending agents trading through a CCP.

McNulty: CCPs are attracting a lot of attention. This started with the drive by regulators to have OTC investment products centrally cleared (the EMIR regulations in Europe will require many OTC derivatives to be centrally cleared) but now I sense that some policymakers want to make sure that the CCPs themselves are robust enough to withstand this surge in new activity without creating a new form of risk to the system. I think the debates on CCPs for the securities lending market are interesting and healthy.

Daswani: That question is yet to be relevant from a securities lending perspective as CCPs have still to achieve any real penetration in this market. CCPs are being held back not so much by their number but by their ability to reconcile their needs as a central hub with a market that is still far from standardised.

Zirpolo: Central counterparties are currently very competitive at the moment, and as long as participants can operate between multiple central counterparties, there aren't too many.

Wilson: Central counterparties (CCPs) in Europe, as of yet, do not have an impact on securities lending. The proposed interoperability across CCPs will make it easier to work effectively across markets and exchanges, but does introduce new concerns regarding contagion from one CCP impacting another.

Finglas: Theoretically, from a practitioner's point of view, the more providers in existence the better the pricing. The effect of having multiple CCPs is that they will become like any other counterparty with which we face legal and credit risk.

What will then be important will be the level of sophistication and efficiency around technology – VaR, settlement systems; and strength of its stakeholders in terms of balance sheet and ability to support the credit and legal risk the CCP itself will be taking on board. These aspects are already managed effectively by the global agency and principal lending community, channelling them via a CCP may simply increase costs and offer limited added value in terms of capital usage.

Transparency has become the focus of the lending clients' attention since the crisis and we do not foresee a change in this approach from their perspective. Currently they do not see any benefit of trading using a trading platform which will create anonymity and remove the oversight they have recently gained.

It is true that the demand side of the business is keen to adopt a structure which allows them to borrow anonymously and possibly get closer to the end supplier. However, lower borrowing costs do not outweigh the benefits provided via the prime broker for all other services offered.

The jury is still out on whether or not this is a viable solution for the securities lending market. For most market participants having a choice of provider is a more beneficial situation to be in however; due to the costs and complexities involved there may be a smaller pool to choose from in the long run. In practise for this structure to work a clearly defined winner needs to be chosen and backed by the main market participants. Unless this happens it is very unlikely to get off the ground.

Coxon: The real question is not whether there are too many CCPs in Europe, but whether a CCP does in fact serve to reduce systemic and counterparty risk for securities lending participants. Or does it when all is said and done just mutualise counterparty risk to the lowest common denominator and add additional costs for industry participants?

While the championing of CCPs was perhaps a natural reaction to the counterparty risk issues surfaced by the Lehman collapse, at BNY Mellon we still trying to figure out what CCPs would ultimately mean for the securities lending business – and, in fact, even what specific problem or problems CCPs would address, let alone solve. After all, the LBIE [Lehman Brothers International (Europe)] default turned out OK for the majority of clients. CCPs won't help with the liquidity issues our clients experienced with their cash collateral reinvestment assets.

What I would say is that, if regulators were to mandate that we move to an electronic bid-offer exchange model in an attempt to ensure best execution on trades, which is perhaps a weakness of the existing negotiation model, then CCPs would fit in with that quite well. But at the moment, there is frankly little momentum or support behind the CCP concept within the industry at this point in time.

Coxon: The real question is not whether there are too many CCPs in Europe, but whether a CCP does in fact serve to reduce systemic and counterparty risk for securities lending participants

Bonn: Regardless of the number of CCPs out there, the question is whether any of them can offer a model that will provide liquidity in the marketplace and offer some form of risk mitigation. We have seen little interest to date from our clients and the ever more complex models with which clients are approaching us would be difficult to accommodate within the current CCP structure. In our role as an agent lender, clients rely on us to perform the many tasks associated with the management of a securities lending service and provide customised solutions to suit their individual requirements. We have yet to see how these structures could be accommodated within a CCP.

That said, CCPs have an important role to play in the ever-developing securities lending indus-

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try, and will inevitably find their niche, but there is some way to go before we can view them as replicating the services of an agent.

Which new European markets are you most excited about?

Zirpolo: I look at Turkey, Poland, Hungary and the Czech Republic within Europe, while the Middle East including Israel are also going to be important markets for us. Volumes remain low, although Turkey is historically the most attractive with a lot of index interest. It suffered last year from a long bias, however interest has increased this year but premiums are not as high

> Gast: with the launch of GC Pooling Equity in March this year, we are adding a new asset class for funding that is cleared via a CCP

Serman: Opportunities are presenting themselves in Turkey, Poland and Israel as these markets develop. Turkish authorities are becoming more receptive to foreign investors and this acceptance has been increasing due to their hefty ownership of the free float, increasing hedge fund activity and an increasing awareness of corporate governance - all part of a positive trend. The key obstacle remaining for securities lending in some of the smaller markets is the limited number of securities available for lending. Some of the exchanges have a shortage of liquid stocks, creating both increased revenue opportunities but also incremental risks.

McNulty: At ISLA we have reconvened our New Markets committee under Anthony Duggan from Goldman and Simon Waddington from RBC Dexia. The early focus of this group is on Russia (where developing derivatives legislation looks to make netting for some products more certain) and the Middle East, where we know that a number of exchanges are interested in starting securities lending markets. We will be looking to influence the legislation in Russia and co-operate with the exchanges.

Daswani: Russia probably represents the most exciting new frontier from a securities lending perspective, with compelling spread opportunities potentially available. Russia represents is the largest and most active of the MSCI Emerging markets, with approximately US$2 billion of liquidity being traded across the MICEX exchange a day. However, on-shore securities borrowing and liquidity is extremely limited.

Prime brokers' feedback suggests hedge fund demand is robust but currently constrained by very limited securities lending supply. An announcement earlier this year that Micex and RTS, the country's two main stock exchanges, intend to merge should improve Russia's financial infrastructure, ultimately leading to the creation of a single operating platform for the trading equities and other products. This should significantly improve the existing fragmented operating structure and improve market access. Northern Trust is actively looking at the securities borrowing and lending opportunities in this market.

Finglas: Interest lies to the east as more and more markets open up to alternative ways of trading. We are keen on any market where there is development in terms of fundamental changes in structure however; this must be matched with client supply and demand. Poland and Turkey have been of great interest to our clients and borrowers alike.

Wilson: We continue to be very positive around new clients and lenders in the Nordic region engaging in lending for the first time. We have focused on this region for many years. J.P. Morgan has a substantial presence and branches in all four countries and is optimistic about the potential new supply entering the market.

Coxon: I get excited about any new European market, where – following thorough due diligence – we can extract material revenue for our clients. That said, I would specifically identify Russia and Poland as potential new markets that could create some exciting opportunities if they were truly opened up and some of the legal and structural barriers to offshore securities lending participation were removed.

Gast: Secured funding markets in Europe across asset classes are becoming more important:

Since 2008, the secured funding markets of Eurex Repo and in particular GC Pooling, experienced significant growth in terms of the number of participants and traded volume. The GC Pooling market where funding transactions are cleared through Eurex Clearing was one of the few secured money markets that functioned well during the crisis was. In addition, with the launch of GC Pooling Equity in March this year, we are adding a new asset class for funding that is cleared via a CCP. This has been well received in the market and we are excited about the development of this new market segment.

It has been proven that our market model is successful for fixed income assets. It will be interesting to see how quickly the market adapts to this model for equities, and see them become an established form of funding collateral.

> Bonn: Over the last six months or so we've seen a number of new exciting markets come on line, including the Czech Republic, Turkey and Greece

Bonn: Over the last six months or so we've seen a number of new exciting markets come on line, including the Czech Republic, Turkey and Greece. Other markets of interest include Russia and Israel. Although State Street is not yet lending in Russia, our due diligence on this market is advanced and we are hoping to go live in the near future as spreads are appealing and we have a sizable inventory. Israel also presents a potential new market.

Theia: The European securities lending market is changing. New demand will come from collateralisation and funding itself. Here securities lending offers great potential. The major challenge is to manage liquidity and collateral efficiently. That will be a new driver of our business.

What do you feel will be the main events in European securities lending over the coming 12 months?

McNulty: Of course the ISLA conference in Portugal will be the main event! Seriously though with so much going on, particularly in terms of regulation, it's vitally important that firms are focused on all of the issues that will affect their business. Conferences are a good way to get a read on what other firms are thinking about and we do have a program that offers a great mix of content, and opportunities to discuss issues and network. Looking further ahead we will see firms continue to analyse the effects of Basel III (and in the case of European insurers, Solvency II) and this may well start to affect how firms do business. I hope that there will be a little more certainty achieved in terms of regulation generally.

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Serman: One should expect increased regulatory oversight with the focus on debt reduction for PIIGS countries, including organised restructuring of Greece's debt. Increased concerns currently exist that major European Banks hold too much PIIGS debt on their balance sheets. Inflation may become an issue if these debt levels are not reigned in as governments will struggle to issue more debt unless they offer more attractive yields. There also will be increased disclosure and reporting requirements imposed by Regulators.

In addition, continued focus on development of CCPs and gauging the market appetite for this structure will be an area to watch. Hedge fund activity will remain tepid, mostly holding on to cash reserves with a wait and see approach to trade activity. Trade activity by hedge funds will be very selective with the eye to modest returns and capital preservation. On a positive note, regulation has also presented opportunities for the investment finance sector in terms of the 'Evergreen' opportunity for those financial institutions comfortable with adopting term structures.

> Wilson: If only I had a crystal ball! The main events impacting the market will be regulatory driven, whether it's European Market Infrastructure Regulation, Dodd Frank, UCITS IV, Basle III, Solvency II, or the Alternative Investment Fund Managers Directive

As the summer months set in, the market takes a deep breath with a cautiously optimistic outlook through to year end where there is the hope of less uncertainly, increased confidence and active participation in the industry leading to robust risk adjusted returns for all.

Wilson: If only I had a crystal ball! The main events impacting the market will be regulatory driven, whether it's European Market Infrastructure Regulation, Dodd Frank, UCITS IV, Basle III, Solvency II, or the Alternative Investment Fund Managers Directive. The ability of market participants to keep on top of proposed regulatory changes will be challenging and will absorb significant time and effort.

Zirpolo: The likely events in the coming year will likely continue to revolve around sovereign debt in troubled countries and any fiscal reform that results from that. Also, the development of a collateral upgrade market and the adoption of new legislative changes should be major themes over the coming year.

Finglas: We are already seeing moves to commit to some of the existing regulatory proposals on disclosure of short positions and pre-borrowing to cover potential shorts. This will hinder demand and require some system enhancements to ensure effective monitoring of cash positions and SLAB trades. The impact will be increasing costs and putting further pressure on margins.

As a result we expect to see moves towards a synthetic based approach from providers in order to bring their client's assets to the market place.

Following the crisis we know beneficial owners have become more sophisticated in their analysis of their providers' indemnification commitments. We believe the focus will become even more rigorous as they continue to question the nature and validity of indemnification offered.

In conclusion, over the coming year providers will need to further demonstrate capability in their risk systems, processes and balance sheets while margins will be squeezed and costs of necessary product development increase.

Daswani: Key events and areas of focus in Europe will include regulatory change – we expect that challenges will continue to be posed with regard to areas including short-selling rules, capital adequacy, creditworthiness, risk mitigation and transparency.

Sovereign debt issues will also remain very much to the fore, with uncertainty continuing to exist over the ability of several countries' ability to service their debt; the result is likely to be continued volatility in the sovereign sector.

Coxon: First and foremost, regulation! The sheer volume of reform now coming down the pipe is unprecedented, and it will be a key focus and challenge for everyone. Number two, will CCPs gain the traction they so badly need, as I think the next 12 months will very much be 'make or break' time for central counterparties and their proponents. Thirdly, will the divergence between lender and borrower in respect of credit quality of collateral continue? This will lead to a disconnect in the securities lending market and lead to liquidity issues and increased volatility.

Gast: As outlined in the September 2010 publication of the Bank for International Settlements (BIS) about repo clearing and settlement arrangements, there is a requirement for resilient market infrastructures in the secured funding markets. Eurex Repo was one of the few markets worldwide operating an anonymous secured funding market based on a resilient infrastructure and thereby meeting the regulator's demand. If you think about medium- or long-term market developments in securities lending, I believe the Quadriserve model in the US could potentially become a role model for the European market thereby serving the entire industry with a holistic approach.

> Zirpolo: The development of a collateral upgrade market and the adoption of new legislative changes should be major themes over the coming year

Bonn: Clearly the main focus will be on European regulation over the next 12 months and beyond. A few of the issues to keep an eye on are: the current work on the EU regulation on Short Selling, Solvency II, the MiFID review, and the Securities Law Directive. Also, new regulations emanating from jurisdictions such Luxembourg and Ireland which are primarily focused on implementing the ESMA (formerly CESR) 10-788 guidelines on counterparty risk and calculation of global exposure. It is undoubtedly going to have an influence over business strategies which will become clearer as some of these points gain clarity.

Outside of the regulatory bandwidth, there will also be focus on monetary policy changes going forward, which could be an interesting landscape as potential rate hikes and weaning off QE could affect demand.

Theia: It's all about regulation. Full stop. **SLT**

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Optimising assets

Driven by regulatory pressures and liquidity squeeze, collateral management takes centre stage, says SunGard's Jane Milner

TECHNOLOGY VIEW

Collateral management has traditionally resided in a financial institution's back office where it has been used to secure financial transactions and to mitigate credit and operational risks. In the wake of the global financial crisis, collateralisation swiftly moved to the top of organisations' agendas.

An enterprise-wide approach to collateral management can help financial institutions optimise their collateral inventory, generate revenue, reduce costs, and address the new and extensive challenges in today's risk-focused world.

Collateral management has always been a hot topic, but it seems to be moving to the top of financial institutions' agendas. Why is that?

Collateral management has always been used as a risk mitigation tool, but post-crisis changes to the conditions around collateral are forcing financial institutions to increase their focus on liquidity and optimisation of assets, including those used as collateral. The growing demand for collateral assets and a widening of funding spreads due to liquidity constraints is making collateral optimisation a crucial topic for many institutions.

In fact, many institutions are looking for more effective collateral management as a liquidity and revenue generator. This closer alignment highlights the evolving role of collateral in not only reducing counterparty credit risk, but also playing a critical role in controlling the cost of trading, revenue generation, and derivatives pricing.

The mandated use of central clearing for over the counter (OTC) instruments and a greater awareness of counterparty risk have increased the cost of using collateral and curtailed the ability to raise revenue from its reuse. At a time when regulatory and cost pressures collide, it is more important than ever for financial institutions to develop an enterprise-wide collateral management programme that offers the benefits of asset optimisation and the assurance of a robust risk management framework.

Can you be more specific about some of the regulatory pressures?

When Lehman Brothers descended into bankruptcy, it left a trail of defaults in its wake and a market full of nervous investors unsure of the creditworthiness of their closest counterparties and the value of their own assets. This unease was especially evident in the less regulated OTC market.

Market participants reacted to the unease accordingly by placing far greater demands on collateral requirements. The increased demands led to tightening of collateral quality, and moves to more frequent and proactive. In addition, global regulators responded by introducing central counterparties (CCPs) in an attempt to reduce systemic risk and bring transparency to the often perceived opaque practices of the bilateral OTC world. While this in theory has greatly reduced counterparty and credit risk, the collateral process involved with central clearing stands to create a huge liquidity vacuum for trading firms.

As regulators continue to work through the implementation of the Dodd-Frank Act, Basel III and Solvency II, change in the financial markets is inevitable. Another certainty is the direct cost of change.

Adapting to a CCP environment involves costs associated with operational and system changes, as well as paying to be a clearing member or trading through a clearing broker. However, the added costs of collateral are also considerable. Clearing members will now have to pay initial margin on transactions, which involves a greater amount of collateral than through a conventional bilateral OTC agreement. End clients may also have to pay higher initial margins under CCP arrangements if margins are segregated versus omnibus account structures. In addition, as there is no single global CCP that covers all jurisdictions and products, netting efficiency under a CCP arrangement is reduced versus bilateral OTC arrangements, further fuelling an increased demand for collateral assets.

CCP arrangements will also limit the level of rehypothecation of collateral. Under traditional bilateral OTC arrangements, institutions often use the practice of rehypothecation as a source of funding collateral. Under CCP arrangements collateral posted would be frozen, putting further strain and additional costs on funding and sourcing collateral assets. This is further exacerbated by provisions in the Dodd-Frank Act and FSA regulations which allow end clients to request segregation of collateral.

A bank's liquidity is also addressed by Basel III, further increasing demand and costs for collateral assets. The updated Accord requires that financial institutions have more structured collateral management policies and stress models in place to monitor, control and report on the risks they are exposed to by various margin agreements and the use of non-cash collateral.

What is collateral optimisation? How would this work?

The post-crisis pressure on balance sheets and the squeeze on liquidity are acutely apparent in the industry's use of collateral. Consequently, financial institutions are now much more demanding of their collateral management processes. They want to see what collateral is available for each and every business line, and they want to assess the relative costs and quality of all collateral in order to best match the available assets for each transaction.

This is commonly referred to as collateral optimisation. Extracting the maximum value from available assets has always been a worthy objective. However, financial institutions have not always actively pursued it or efficiently used the assets available to them for collateral purposes.

In the past, either the quality of collateral has been higher than required, or expensive forms of collateral were used when cheaper alternatives were available. Often, long collateral had been left to lie dormant rather than reinvested for trading purposes such as securities lending, repo, or through rehypothecation to satisfy the firm's own collateral posting obligations. Additionally, available collateral assets are commonly spread across different entities within the firm, and therefore these assets are not optimally used prior to accessing external supply. Financial institutions are now looking to address this situation and optimise their use of collateral across the firm.

There is a lot of talk about 'enterprise' collateral management – what does that really mean?

The first step to achieving a more optimised usage of collateral is to establish a global, holistic, real-time view of the inventory of assets to provide an up-to-date list of available collateral for every business line's funding requirements. The firm must then be able to match this single view of available assets with a single view of the various collateral requirements across all business lines and the relative eligibility criteria of this collateral for all counterparties across all business lines.

Collateral optimisation algorithms (for example, "cheapest to deliver") can then be applied to the pool of available eligible assets when pledging collateral in a transaction to determine the best possible combination of assets to use as collateral from both an economic and operational perspective.

In addition to collateral optimisation, an enterprise-wide view of the collateral function provides many obvious benefits – firm-wide view of assets for trading and collateral, cross-firm holistic views of counterparty risk, reduced operational risk, increased visibility, better liquidity management, more effective stress testing,

funding cost control and management, and revenue generating opportunities.

How can technology help?

Even when business processes themselves have been adapted to work in an enterprise way rather than across silos, and once the firm has established a single, visible, enterprise-wide inventory of available assets which can be mapped to the list of collateral requirements and conditions, there are still additional steps that must be taken in order to enable effective asset optimisation and allow active management of collateral to thrive. All of these changes have significant technology implications and will require advanced enterprise solutions to enable them to be effective.

Financial institutions will require business logic engines that can look at both the asset inventory and the collateral requirements and make intelligent and automated decisions on a frequent basis. The collateral allocation process will need to be linked to the various trading and post-trade systems so that collateral arrangements that accompany every transaction can be swiftly acted upon.

The ideal system offers a suite of fully integrated and flexible modules that offer specific, detailed functionality for the separate divisions involved in collateral management – be they securities lending, OTC and listed derivatives or repo. Such an approach offers the best way to build a flexible and enterprise-wide foundation for collateral management that will meet a firm's growing requirements, from a centralised inventory of assets through to global risk management.

What are the technology challenges in implementing enterprise collateral solutions?

While enterprise collateral management offers many benefits, it can also present a number of operational, organisational and technology challenges.

Many financial institutions are constructed as composites of multiple silos, each with their own separate cultural, operational and technological identities. Melding these often conflicting properties into one firm-wide system is therefore a complex task and must be approached realistically, through gradual steps rather than one 'big bang' initiative.

What is SunGard's vision to help customers address these complex challenges?

SunGard is working with customers to establish a componentised approach to enterprise collateral management, as well as providing the specialist consulting expertise required to help address wide organisational and operational concerns. Financial institutions require the ability to gain:

- Enterprise transparency of collateral inventory across business silos, including the dimensions of geography, asset classes, credit rating etc.
- A single view of exposure to a counterparty across all product lines within the firm
- Cross-product margining capabilities (where appropriate)
- Collateral optimisation and use of algorithmic modeling to apply the right collateral to the right transactions at the right time based on defined rules and priorities
- Standard workflows across multiple product types designed to improve the process efficiency of documentation, valuation, reconciliation, margin calls, instructions and dispute management
- Automation to drive straight-though processing and enable near real-time data availability
- Technology and operational readiness for central credit counterparties to ensure faster time to market and competitive client services

For sell-side banks and brokers looking to minimise their balance sheet impact and meet the demands for profitability, an enterprise-wide collateral management program can give them the ability to view all available inventory across multiple asset classes and to fund collateral or trade directly from these positions.

Additionally, they can view all counterparty exposures, maximise netting opportunities and minimize collateral pledges, produce comprehensive reporting to satisfy both internal and transparency demands of regulators and investors.

Asset managers and institutional investors operating on the buy side are looking for a more efficient collateral management process that will improve risk mitigation controls. An enterprise-wide approach allows for holistic, real-time exposure management and risk calculations that reflect up-to-the-minute changes in the risk profile of their counterparties. Structured and automated workflow management, standardised across asset classes, will also ensure that no collateral calls are missed and the quality of collateral can be verified through a profiling program of the various eligibility criteria.

For the various intermediaries operating between buy- and sell-side firms, such as prime brokers and global custodians, an enterprise-wide collateral management system must meet their need to service clients more effectively and with increased transparency. This means providing a system with a flexible and hierarchical structure to support the different requirements of multiple entities. Simple workflow management and clear segregation between multiple clients is also essential, along with support for cross-netting and ad hoc reporting requirements.

The system must also be able to support an intermediary's commercial ambitions by enabling them to offer the solution directly to their own clients on a white label basis, thus providing them with the opportunity to differentiate themselves from their competition.

Collateral management is clearly in a state of rapid evolution in the new reality of the post crisis world. Rapidly changing regulatory regimes, increased margin requirements in an environment with reduced access to short term liquidity means firms are reassessing how they manage their collateral processes and control the demands made upon them. Taking the holistic, enterprise view is key to creating a coherent response to this new paradigm.

Many organisations are now taking steps to move from basic collateral management to the more sophisticated world of enterprise collateral optimization. These are the firms that will seize the opportunities that lie ahead. As the industry responds to dynamic change, firms that make the right investments will emerge as the winners. **SLT**

Jane Milner
Head of strategy for securities finance and collateral management
SunGard

Big interview

Martin Chen, VP of Chinatrust, speaks to Bryan Camoens on the dilemma facing many, tri-party collateral manager or managing collateral in-house

BRYAN CAMOENS REPORTS

Bryan Camoens: Could you outline the global economic landscape and its implications for Asia's collateral management and securities lending?

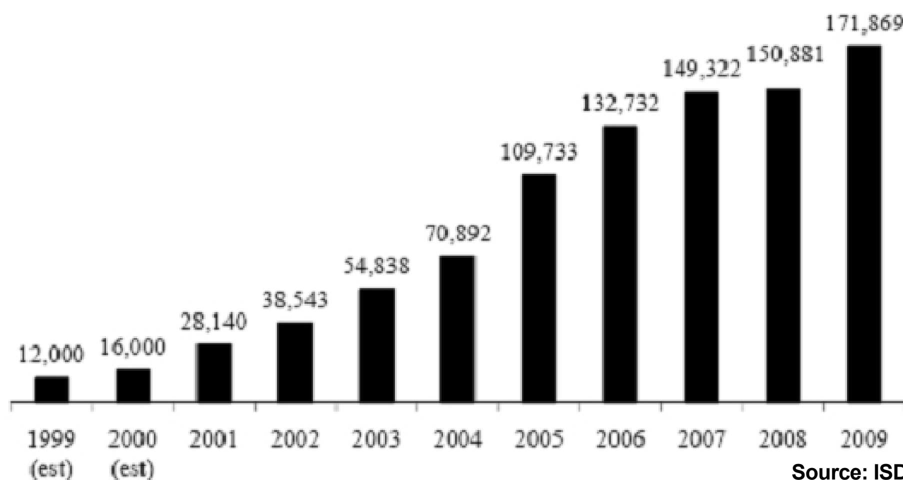
Martin Chen: Generally, the regulations like Dodd-Frank, Basel III and Volcker Rule will have impact on collateral management and securities lending activities. The degree of impact still needs to be further assessed, but it is expected that the new regulations will promote the use of central counterparties (CCPs), increase costs and thus reduce lending income.

In Asia, there are CCPs in countries like Korea and Singapore, although its use is not mandatory. According to a survey conducted by Data Explorers in the 2011 Annual PASLA Conference ("Dataexplorers Survey"), the majority of participants thought that a central counterparty will gain critical mass in the securities financing business only if it is mandated by regulators. In Taiwan, Taiwan Stock Exchange (TWSE) has been a CCP for competitive auction SBL transactions. However, we didn't hear any plan to set up a CCP in Taiwan for OTC derivatives. Each country may have its CCP, but the integration across the region or the set-up of a regional clearing house will be a big challenge.

Camoens: In your opinion what are some of the key drivers in Asia for the rise of interest in effective collateral management?

Chen: The rise in OTC derivatives trading volume as well as the increase in number of CSAs signed are the key drivers in Asia for using effective collateral management. More and more institutions have signed CSAs in Hong Kong, Singapore and Korea. We also expect that institutions in Taiwan (eg, insurance companies) will sign more CSAs, although the growing pace may be slow compared with the other Asian countries (Many institutions, especially banks, still prefer to use cash as collateral as it is more convenient).

Growth of collateral managements reported by respondents, 2000-2010 Surveys:



Source: ISDA

Camoens: How do you go about understanding the characteristics of Asia's fragmented market & its implications for collateral management & securities lending?

Chen: In Asia, SBL standards vary from countries to countries. Japan and Hong Kong are considered markets with most efficient securities lending model in Asia, while the other countries still need improvement.

Let's take Taiwan as an example. Its SBL model is quite similar to that of Korea. There is a CCP for auction type of SBL transactions. Foreign investors prefer negotiated type of transactions as it is more flexible; for example, collaterals can be arranged offshore. Market participants have been complaining about T+3 recall cycle, which is not consistent with T+2 settlement cycle. Besides, tax treatment for manufactured dividends is very complicated in Taiwan. As for India, many participants still think it is a difficult market to enter. We can also monitor Chinese market closely.

China opened up margin trading and short selling in March 2010. There might be an SBL market once the regulator allows brokers to borrow shares for further lending out to clients. Currently, brokers can only lend their own positions to clients for short selling. Generally speaking, many emerging markets in Asia do not operate SBL efficiently but we expect that they will be improved gradually when the market size grows.

Camoens: When it comes to managing counterparty risk effectively through collateral management what are some of the challenges that are often faced?

Chen: Many institutions may be in a dilemma of using a tri-party collateral manager or managing collateral in house. It really depends on the situation of the institution and its strategies.

They have to conduct a cost-benefit study and come out with a choice which best fits. If an institution does not have a big volume of collateral, normally they may wish to outsource collateral management. Considering the increasing complexity of pricing OTC derivatives, it might be more appropriate to rely on a tri-party collateral management service provider.

Revenue generation through investing or rehyphothcation is also one of the institution's main concerns in addition to risk mitigation. Moreover, recent regulatory reforms may also push institutions to outsource collateral management.

Camoens: Going forward how do you expect the collateral management & securities lending market in Asia to evolve over the next 18 months?

Chen: We are quite optimistic about the future of the securities lending market given that there will be more mergers and acquisitions and capital raising activities as well as increasing hedge fund investments in this region.

According to the Dataexplorers Survey, 40% respondents respond that revenues will increase by more than 10% over the coming year, and 46% of respondents respond that revenues will increase by up to 10%. It is expected that Hong Kong, Taiwan and Korea may have good growth in volumes this year.

For collateral management, the demand will also increase due to growth in securities lending and derivative trading activities. Besides, non-cash collateral may increase. We expect the demand for tri-party collateral management will grow. Meanwhile, market participants should be monitoring the issues of lack in demand as well as the continued growth in supply.

Martin Chen will be speaking at Collateral Management & Securities Financing Asia 2011

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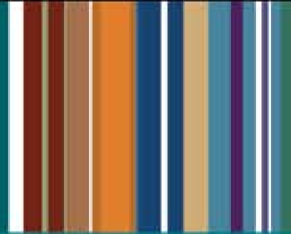

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In from the cold

Access to collateral is key to the success of the market, says Euroclear's Olivier de Schaetzen

EXCLUSIVE

The recent financial crisis can be likened to a bitter, unchartered tundra, from which only the most prepared explorers arrive home unscathed. The shuddering events of 2008 and 2009 brought some painful liquidity and exposure management issues to the fore, as liquidity dissipated and the interbank lending markets came to a halt. Counterparty trust, in many instances, became glacial. The entire banking industry will not forget its experience in a hurry.

As a result of the crisis, one of the most prominent trends we expect to see is the continued move towards complete collateralisation of all exposures, irrespective of the type of transaction. It had been common market practice to collateralise exposures from some types of transactions, such as repos, central bank credit and securities lending transactions, but others were not, such as OTC derivatives and many money market transactions.

Regulators will be expected to have greater influence in ensuring that this happens. Their objective is to curb banks from relying too heavily on short-term funding, while requiring banks to better mitigate their operational risks. The impact of regulatory measures we expect to see worldwide will link collateral management intrinsically with the cost of funding for banks. This will increase the need for better operational efficiency in the movement of collateral, particularly as the markets become more global and the location of actionable collateral remains fragmented.

National central banks rally to the rescue

If we consider the trends of just five years ago, the most pronounced difference today is the fundamental change in the sources, flows and means of access to liquidity within the interbank market.

From a collateral management perspective, in the past, the market's focus was largely on collateral usage. Discussions between collateral givers and takers centred on expanding the range of assets to be used as collateral, including a variety of structured securities. Today's risk-conscious behaviour dictates a shift to the use of high-quality and, more important, highly liquid collateral. Firms receiving collateral will not only evaluate the probability of being able to liquidate collateral within the margins but, also the capacity of these collateral assets to generate liquidity, including through their central bank.

The massive intermediary role of the central banks in Europe during the crisis stabilised the global banking system. However, the flipside is that a large portion of the securities financing business has been relocated to national central banks.

During turbulent market conditions, it is understandable that banks need to be as close as possible to their primary source of liquidity, i.e. their national central bank. Over the past few years, banks significantly increased the amount – to more than €2 trillion - of collateral deposited with central banks to meet both their routine and contingency liquidity needs. The composition of collateral held within the Eurosystem changed dramatically, where government debt now represents only around 11 per cent. In comparison, in the European interbank repo market, about 77 per cent of European securities used as collateral is government debt. Therefore, the current exit strategies being employed by national central banks are changing the collateral landscape in Europe, as banks alter their models to optimise their use of available collateral.

Triparty times

All of the agents serving as triparty collateral managers were sternly tested during the crisis and all performed solidly. Euroclear Bank's triparty collateral management services were no exception.

Taking on board the lessons learned from the crisis, and by request from firms looking to collateralise their credit exposures, it became essential to ease access to central bank credit. Service upgrades were implemented quickly to automate the collateralisation process for firms looking to obtain this form of credit.

Today, some national central securities depositories (CSDs) provide intraday auto-collateralisation mechanisms that primarily support delivery-versus-payment settlement in central bank money. Euroclear UK & Ireland, in fact, provides both an intraday collateral management service and an overnight Delivery-By-Value service (DBV) that support collateralised transactions between banks using baskets of eligible securities as collateral.

In June 2011, Euroclear will introduce term DBVs to the UK market, where settlement banks will be better able to manage their liquidity needs with the Bank of England. In addition, triparty collateral management services will be available in late 2011 for the three Euronext market CSDs, namely Euroclear Belgium, Euroclear France and Euroclear Nederland.

When the international CSDs, such as Euroclear Bank, serve as triparty collateral managers, they help clients access a very large pool of collateral comprising a broad range of securities. They are experts at optimising collateral usage and at managing term financing business in a seamless manner, identifying and substituting collateral, as and when required, using automated processes. Real-time reporting keeps clients informed of these movements at all times.

Since the crisis, the types of firms using triparty services have expanded. Many central banks were already using these services to manage their reserves, their own investment activity and some to manage their monetary policy operations, ranging from routine collateral operations to arranging contingency liquidity facilities. In addition to the broker-dealers, custodians, cash-rich institutions and corporates availing of triparty services, more central counterparties (CCPs) are becoming active triparty service users to manage their core margining processes and for their new General Collateral products.

The European Council of the International Capital Market Association recently reported that triparty repos rose from 7.9 per cent in June 2010 to 11.5 per cent in December 2010, as a percentage of the overall €5.9 trillion repo market in Europe.

A supportive structure

New regulation will provide incentives in the form of reduced capital requirements for firms to pursue longer-term funding arrangements and greater operational efficiency. As triparty services have been designed to support term financing in a very efficient way, we expect more business flows to triparty agents.

Fully automated processing of collateral substitutions, margin calls, custody operations and so forth make a compelling business case for firms to outsource these responsibilities to a neutral agent like Euroclear Bank. Moreover, a fully integrated collateral re-use feature alleviates liquidity constraints that are inherent to term cash investments.

As more and more regulatory focus is on OTC derivatives, and the use of CCPs in this market segment, triparty services will be helpful in managing the systemic risks arising from even more CCP and collateral fragmentation. And, as CCP interoperability becomes a reality in the future, triparty services can also be of assistance in this context.

The thawing terrain

We also strongly believe that triparty securities lending is helping the interbank lending market to rebuild confidence and regain lost ground, as the "great counter-party trust freeze" starts to thaw. In fact, volumes in triparty securities lending are now back to pre-crisis levels.

Collateral is becoming an increasingly scarce resource. Easing access to deep and diverse collateral pools, as well as automating the process of mobilising assets for collateral management purposes, are top priorities. It is time for all firms to come in from cold, safe in the knowledge that their exposures are fully covered, enabling them to turn to their true areas of expertise while specialised service providers deal with the collateral administration. **SLT**

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CCPs - Panacea or Boadicea?

Data Explorers' Will Duff Gordon examines the case for and against central counterparties

MARKET PERSPECTIVE

Ostriches put their heads in the sand so let's instead put our head to the task of the CCP debate. We know regulators are keen on this model and there are at least three published or imminent articles looking at the suitability of a central counterpart for securities lending. Even if the securities finance market is focused on other issues, other people are talking about this for you; it is on the agenda whether people like it or not. Much of the talk so far is sorely lacking in detail so we will approach this issue through the eyes of the four players in the short selling chain but let's start with the regulator.

Regulators

First up, we will start with the rationale of the regulators. At the crux of the Bank of England's desire to see changes in the securities lending markets was the speech made by Deputy Governor, Paul Tucker, in January 2010 where he set out five ways that securities lending could learn from the credit crisis. It was this speech that prompted the B of E to produce a short paper on CCPs that was discussed at the March quarterly meeting where the industry airs its views with the Bank.

Interestingly, a central counterpart is mentioned as a tool to meet just one of his areas of concern and would have no bearing on the other four areas in need of improvement (many of which are now being addressed). That said, it was his first point, but he equally admits that it may not be suitable 'as may well be the case for some types of security.' Dovetailing his comments on considering whether securities lending, 'might lend itself to central counterpart clearing' are two phrases arguing for 'greater transparency' and 'aggregate data' to be published. However, rather than pushing this whole market onto a CCP platform, it is worth asking whether there are other means to ensure more information is made more widely available as much of the data is already being aggregated.

Beneficial owners

The owners of the assets that drive the securities lending market are arguably the most powerful players in the chain and the least enthusiastic about a CCP. To see the ideological divide between proponents of CCPs and their detractors, look at the tone behind this comment by OneChicago's David Downey in the last issue of Securities Lending Times. David says that a loan is, "actually a disposition of an asset – whereby they get their forward agreements". While not inaccurate, this is not how the CIO of a pension fund would describe it. For them, securities lending represents a temporary transfer of an asset that they remain the owner of. They continue to be the official shareholder and thereby responsible for collecting dividend income and retaining the right to recall the shares back to vote with their reputation at stake should the borrower abuse their use of this asset. Buying and selling things requires much less directing; as long as you agree with the price and deliver and or receive the asset in question nothing matters. Life is rather different when lending something. As such, the more control they have over who borrows their shares and under what terms the better. Having spent the last few years tightening up their lending guidelines, it is understandable why they now question the value of forging this vice like grip by lobbing their shares into a CCP.

Hedge funds

Hedge Funds are the most eager for a CCP structure to exist and they are early adopters of the AQS service that uses the OCC as the clearing backstop. CCPs offer them the ability to borrow anonymously – a big plus where secrecy allows them to keep their edge. According to the OCC's website securities lending volume is up 47 per cent year over year with 330,777 new loan transactions.

The buy side and especially the very biggest funds have long been eager to deal as directly as possible with the asset owners if it offers lower borrowing costs. At the same time, the prime brokers remain a core service provider and one they do not wish to ostracise for all the other services they offer.

Custodians

On the record, Custodians are happy to make use of CCPs and have no religious objection – if their clients are happy. In reality, the CCP offers no great benefit to the major global custodian community whose deep relationships with the brokers and well staffed teams of traders are geared up for a bilateral OTC market. They would argue, convincingly, that if it ain't broke, don't fix it. Collateralised lending of shares has occurred trouble free for decades. They even made money from the bankruptcy of Lehman due to the liquidation of LEH's collateral, which was carefully chosen and marked to market on a daily basis, leaving them in surplus. In fact, if you stress test (using our Risk Adjusted Returns framework) a model portfolio of loans against every major 20th century shock, you only lose money when interest rates rise yet bonds drop. So, why the need for a CCP when risk is well managed as things stand?

Prime brokers

This is a mixed bag. Certain synthetic prime brokers (Soc Gen, the former Fortis) have backed CCP structures such as SecFinex. However, the main brokers, hitherto, have been fairly disinterested. This may change as Basel III and Dodd Frank pull the rug from below their feet if a CCP leads to less balance sheet usage.

Final word

It is high time we addressed this issue and in future pieces we can address more specific is-

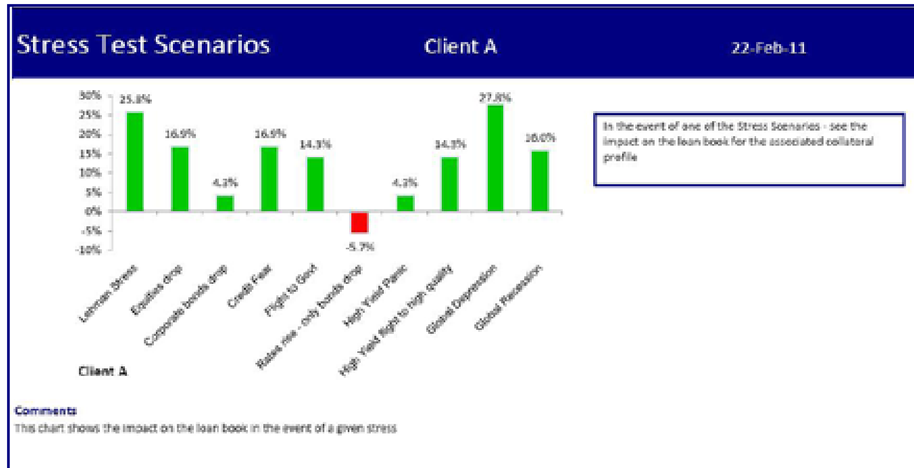
sues such as whether certain instruments lend themselves to CCPs more than others, like bonds. Also, certain types of counterpart will make use of CCPs more than others. Then, as the market fragments between OTC and CCP, there will eventually be a coming together when the offering is good enough to drive all of the activity.

For now, the most powerful players in the securities lending market have contented themselves to automate some of their less juicy trading and operations, via Equilend for example for easy to borrow names, while leaving the rest as it always has been.

While withholding tax rates differ around the world and securities lending entails mucky corporate actions activity it will be some time before a dominant equity CCP comes to the fore. Also, there is much work to do to move the minds of the beneficial owners.

As we all know, it was the re-investment of cash collateral that created distress at the time of the credit crisis. With this activity now handcuffed to the least risky over night assets, it seems that the systemic risk is not there just to justify so much upheaval to force the whole market onto a CCP.

If transparency is what regulators want, is worth asking whether there are far easier ways to achieve this? **SLT**



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Training and Education

23-24 Jun | **London** | **Collateral Management Market and Documentation** | **Marcus Evans**

This sophisticated 2-day course will be delivered by three key industry experts who will be covering the key issues of collateral explained from an operational, risk and legal perspective.

5-6 Jul | **London** | **International Securities Lending** | **FinTuition**

A two-day course which delves in to the business covering the motivations and roles of market players, the main demand drivers, risk and return, counterparty selection, alternative lending options, and the current state of the market.

21-22 Jul | **Singapore** | **Repo and Securities Lending** | **Euromoney Training**

You will be taken through the operative terms of the agreements, events of default, and the termination and close-out provisions. In addition, the role of custodians and agents will be explored, including a detailed discussion of the tri-party agreements that are used to facilitate these discussions.

27-28 Jul | **London** | **Global Collateral Management** | **FinTuition**

Explaining the rationale and current best-practice functioning of collateral management programmes for financial institutions. The course is therefore suited to individuals who are either starting up a collateral management function or seeking to improve their unit's capability.

1-3 Aug | **New York** | **Repos and Securities Lending: Negotiation and Documentation of New York and English Law Documentation** | **Euromoney Training**

This course will offer a start to finish discussion of the key terms of the Global Master Repurchase Agreement and the Global Master Securities Lending Agreement, as well as the agreements used in the US domestic market.

18-19 Aug | **London** | **Repo and Securities Lending** | **Euromoney Training**

This course will offer a start to finish discussion of the key terms of the Global Master Repurchase Agreement and the Global Master Securities Lending Agreement, as well as the agreements used in the US domestic market. Attendees will be taken through the operative terms of the agreements, events of default, and the termination and close-out provisions.

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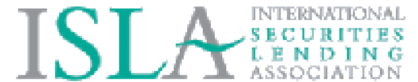
ISLA 20th Annual International Securities Lending Conference



Date: 28th-30th 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).

12th Annual Collateral Management

Date: 7-9 September 2011
Location: London
Website: http://www.marcusevans.com

This collateral management event, brings together senior figures from the collateral world in order to address key topics including regulatory reform, automisation, optimisation and how to attain best practice in operational procedures.

The Finadium 2011 Conference

Date: 20 September 2011
Location: New York
Website: www.finadium.com

Themes for this year's conference include ETFs in securities lending, transparency in financing for hedge funds and their investors and the impact of CCPs on collateral management. Lunch is provided and networking is encouraged.

16th European Beneficial Owners' Securities Lending Conference

Date: 26-27 September, 2011
Location: London
Website: http://www.imn.org/Conference

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Industry Appointments

Oberon Knapp has joined eSecLending's Boston office as senior vice president, business development.

With 15 years of financial service experience, Knapp has specialised in securities lending since 2005. Most recently, he was a senior managing director at Premier Global Securities Lending (PGSL). Prior to PGSL, Knapp was a managing director and co-head of global account management at State Street in its Securities Finance division.

While at State Street he managed many of the firm's largest and most sophisticated client accounts in the insurance, asset management, pension fund and the endowment and foundation sectors. Before joining State Street, Knapp held various positions at Deutsche Asset Management and FleetBoston.

"I am excited to be joining eSecLending," stated Knapp. "Their differentiated process presents a strong advantage in today's environment, particularly in recognition of how beneficial owner views have evolved. I look forward to utilising my skills and experience to help refine and promote solution driven offerings to eSecLending's target market."

The International Swaps and Derivatives Association (ISDA) has appointed **Athanassios Diplas** of Deutsche Bank and **Charles Mulhern** of Wellington Management Company as co-chairs of the ISDA Industry Governance Committee (IIGC). The new co-chairs succeed Stephen O'Connor, who has stepped down as IIGC chair following his election as chairman of ISDA's board of directors in April, 2011.

The IIGC is at the head of the industry's governance structure and oversees strategic market practice and post-trade issues in the over-the-counter (OTC) derivatives markets. It is the main interface for global supervisory contact and serves as a forum both to mobilise industry resources and track the progress of key initiatives.

Mulhern is the director of investment data and derivative services within Investment Administration at Wellington Management Company, LLP. Mulhern actively participates in several industry forums including the Asset Management Group of the Securities Industry and Financial Markets Association and the Operations Steering Committee of ISDA. He joined Wellington in 2005.

HazelTree Fund Services has elected **Ron Suber to** its board of directors.

As senior partner and head of global sales and marketing for Merlin Securities, Suber will provide HazelTree with the benefit of his more than 20 years of experience in sales, marketing, strategy and business development across the hedge fund, broker dealer and registered investment adviser industries.

"Ron is a true leader within the hedge fund community and our Board is thrilled to have him," said HazelTree CEO Stephen Casner. "His energy, ideas and intuition will add invaluable perspective to our operations and help us continue being the pre-eminent provider of Treasury services for hedge funds."

Suber stated, "HazelTree is one of the most dynamic, innovative companies serving our industry today. Their unique solutions and services are redefining the way hedge funds manage their Treasury function. HazelTree provides unprecedented levels of value and service to hedge fund senior management and the funds' investors."

Singapore Exchange has strengthened its Risk Management and Regulatory (RMR) team with new appointments to maintain robust regulation in today's rapidly changing financial landscape. The enhanced RMR functions include "Regulation", "Risk Management", "Clearing Risk", and "Regulatory Development & Policy". The changes are effective from 1 July 2011.

Richard Teng is appointed as head of regulation with expanded responsibilities in overseeing Issuer Regulation, Catalist Regulation, Member Supervision, Market Surveillance and Enforcement. Teng's new role will focus on the supervision of issuers, market participants and intermediaries. He joined SGX in 2007 as head of issuer regulation and chief of staff for the RMR team. In his new role, Teng will closely support Yeo Lian Sim, the chief regulatory officer.

In addition to Teng, **Kelvin Koh** is appointed as head of market surveillance and **Annie Ong** as acting head of enforcement.

With increased focus on risk management, **Agnes Siew** is appointed as head of clearing risk and is responsible for the formulation of risk frameworks for new products and services. The risk management function will assess the risk frameworks and continue to be responsible for risk monitoring and management of clearing members and over-arching risk policies.

The former Regulatory Policy unit has been expanded to include legal functions related to regulation in order to provide a more holistic perspective in regulatory formulations. The expanded unit, known as the "Regulatory Development & Policy" function, is headed by Mohamed Nasser Ismail.

"Sound regulation is integral to the attractiveness of our markets. We will maintain the high regulatory standards and effective risk management that are important for our trading and clearing services," said Lian Sim, chief regulatory officer, Singapore Exchange. **SLT**

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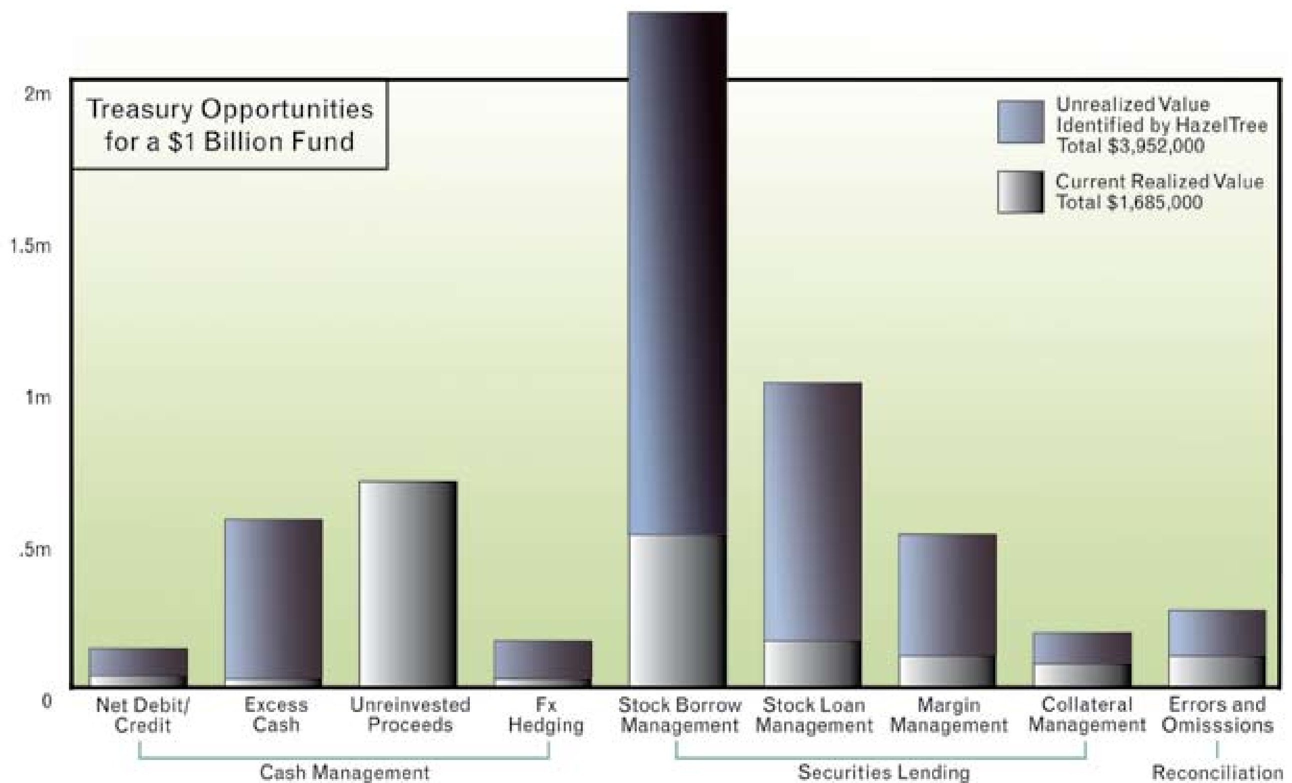

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