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Euro short selling bans extended

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All four European nations which introduced short selling bans in mid-August extended those decisions, while market participants struggle to adapt to disparate rules.

Belgium, France, Italy and Spain released statements detailing the companies affected by the ban, as well as limits and exceptions under the coordination of the European Securities Markets Authority (ESMA). Authorities in all four countries will review the bans at the end of September and, in an attempt to harmonise, Greece announced its intention to do so as well. In total, authorities in 29 European countries have an assortment of short selling restrictions of varying lengths.

Regulators stressed that the measures are intended to prevent market abuse.

"I don't think there is a genuine concern among regulators that there is widespread market abuse using the mechanism of short selling," said Darren Fox, partner at law firm Simmons & Simmons. "Often, market abuse is a convenient label for regulators to use in order to exercise powers they have been granted by their parliaments to take these kinds of short-term prohibitive measures, powers that they would not have in the absence of that label."

French banks' share prices were hit particularly hard in early August, with some suffering double-digit losses, when market rumours spread about a potential downgrade of France's sovereign debt. All three major rating agencies denied this was the case.

On August 18, French regulator, the Autorite des marches financiers (AMF), was forced into ingnominious retreat when it could not impose restrictions on traders rolling over short positions on indices operated by Stoxx.

The resulting market frustrations meant Fox spent the whole of last week talking about nothing but short selling with his primarily buy-side clients.

The ban prohibits net short positions in an underlying stock in an index, explains Fox, but each regulator has also introduced exemptions for the purposes of hedging risk of exposure to European equity markets.

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NEWSINBRIEF

SBL should be part of global liquidity hub - Kurt Salmon

Securities lending and repo desks should be part of a global liquidity hub for lenders, wrote Kurt Salmon.

The consultancy firm notes that Basel III regulations will increase the costs of securities financing activity, requiring higher capital buffers and haircuts as well as more accurate measures of counterparty risk exposure.

Meanwhile, regulations will also increase demand for highly liquid or AAA assets with priority given to high-liquid assets on balance sheets.

readmore p3

Busy summer for SBL in Sweden - Data Explorers

Securities lending activity has been relatively busier than normal during Sweden's summer months on the back of disappointing economic news, write Data Explorers.

Looking at securities lending flow data over over the last month, though activity has dropped by 1.8 per cent, the expected decline would be in the neighbourhood of 10 per cent, according to Data Explorers.

This is against the backdrop of falling global markets while, in Sweden, industrial production and export demand have slumped.

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Euro short selling bans extended

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"We have had literally hundreds and hundreds of enquiries by phone and email every day since the bans were introduced," he says. "There is an enormous sense of confusion and the market needs clarity, while regulators have been very reluctant to give any ground in terms of explaining the finer details of their hedging exemptions."

Though the law firm has a regular quarterly online product (called Navigator) to inform clients about the varying regimes, changes during the latest European short selling ban have been so frequent that over and above regular website updates, Simmons & Simmons has started a twitter feed.

"We thought Twitter would be an efficient delivery mechanism to communicate changes quickly to clients, particularly as they might be trading one minute but the regulator changes its mind and then it becomes a problem," said Fox.

The majority of ban enquiries, he noted, have related to indices - particularly the EuroStoxx50 SX5E contract, a broad based index containing nine of the banned stocks. Hedge fund managers are unsure about whether their portfolios meet the required standards in order to be able to use that index in accordance with the various hedging exemptions.

Responding to that market need, US-based derivatives exchange OneChicago offered futures in the four country specific ETFs a week after the ban was implemented.

"We listed these products to provide an avenue for market participants to gain or adjust short delta exposure to equities in the countries that instituted the ban," wrote Tom McCabe, COO of OneChicago.

"Our securities futures products were not subject to that ban, and in fact do not have any short delta restrictions," he said.

Fox says that this kind of product, which replicates an index but without the banned stock, will be interesting to traders that typically use the Eurostoxx50 to go directionally short in the eurozone countries. The problem, he says, is whether liquidity will be there when a trader wants to exit the position.

Meanwhile, critics of such bans point out the inefficacy of the strategy in stabilising asset prices.

Before the short sale ban was even implemented, global securities lending flow data showed that the scale of short selling was dwarfed by the supply of shares to short and nowhere near the levels reach ahead of the last credit crisis in 2008, according to Data Explorers.

Moreover, the securities lending research firm states that there is little discernible pattern when comparing price changes in the week with levels of short interest for European large caps.

That, according to Data Explorers, reinforces the argument that the price drop in the first week of August, immediately after the US debt downgrade and about week before the short sale ban, had little do with short selling.

SBL should be part of global liquidity hub - Kurt Salmon

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"Borrowers decrease cash and increase equity collateral impacting the global exposure of the institution," wrote Kurt Salmon, adding that as a consequence, it becomes strategic for market participants to re-design in-house or outsourced collateral management processes.

Meanwhile, the number of agents providing automated securities lending and borrowing solutions is increasing, confirming the strong interest of the market in services such as facilitating real-time transactions, collateral monitoring and optimising costs while mitigating risks, the consultancy firm added.

SBL "key" for Northern Trust's new mandate

Baerum Kommune identified Northern Trust's securities lending programme as a key factor in awarding a NOK600 million (€76.4m) asset servicing mandate.

"As a municipal investment fund, our selection must stand up to public scrutiny. Northern Trust's robust securities lending programme and processes were amongst a number of key factors in our decision making, together with its long track record in, and commitment to, the Nordic region," said Astrid Auran Nesbo, director of finance at Baerum Kommune.

Northern Trust will provide global custody, securities lending, transition management and foreign exchange services.

"Northern Trust has a long heritage of working in the Nordics, combining our global strength and capabilities with local expertise and local language speakers," said Madeleine Senior, managing director of Northern Trust in the Nordic region.

"Our Nordic client base is diversifying. We are able to offer optimal solutions to a range of institutional investors and asset managers that need to meet complex reporting requirements, as well as compliance and regulatory obligations, whilst also ensuring that their assets work hard through our global securities lending programme, transition management and foreign exchange services," she added.

State Street renews Lloyds Banking Group mandate

Lloyds Banking Group has renewed and extended its existing securities lending contract with State Street.

State Street will serve as the preferred single provider of middle office, custody, fund accounting, depositary, securities lending and investment administration services for Scottish Widows and SWIP. The consolidated portfolios include investment accounting for more than £200 billion of assets and the services currently supported by other providers will migrate to State Street during the next 18 months.

Following the acquisition of HBOS in 2009, Lloyds Banking Group reviewed all its outsourcing options to determine how best to develop a single operating model across the Group. An agreement has been reached to enhance the existing working relationship already in place between State Street and Scottish Widows/ SWIP and extend the contract to cover legacy HBOS investment administration.

"We are delighted that we have been able to extend and strengthen our strategic outsourcing relationship with Lloyds Banking Group and feel it is a strong endorsement of our commitment to the securities servicing business," said Joe Antonellis, vice chairman of State Street. "We believe we can assist Lloyds Banking Group to positively address the many changes taking place in the industry, such as Solvency II".

"We are confident that both SWIP and Scottish Widows will benefit from our leading technology systems, depth of resources and commitment to excellence in client service." continued Antonellis.

SecFinex cleared for take-off

CCPs are being "blown along by regulatory winds and pragmatism", said Data Explorers, presenting the case of SecFinex, the first live centrally-cleared multi-lateral trading facility (MTF) for securities lending in Asia, Europe and the US.

The entry of clearing services for the securities lending market comes at a time when beneficial owners have narrowed distribution pools in the wake of the Lehman collapse. But lenders should consider that both strategies can be adopted, said Jonathan Lombardo, head of sales at SecFinex, speaking to Data Explorers.

"Does a beneficial owner want to lose out on that potential revenue because the agent lender community might be a little reluctant to engage?" said Lombardo.

He points out that the latest ICMA figures show that 28 per cent of a $6 trillion fixed income lending industry trades via CCP – all broker-to-broker dealing.

And, in cooperation with trading partners LCH. Clearnet and Six x-clear, SecFinex can provide full post-trade functionality while also providing cost savings on other transactions such as monthly reconciliations.

Admittedly, Lombardo said it is early days yet - a reality punctuated by relatively low volumes. SecFinex currently has an estimated $300 – 400 million on loan and $1.2 billion of liquidity on a daily basis. But, Lombardo said, the CCP is looking to treble or quadruple that over the next year as regulation drives trades onto exchanges.

Apart from increased capital requirements from Basel III, other regulations intended to prevent systemic risk such as EMIR, MIFiD and Solvency II are set to hit the industry. Rules in Basel III are particularly pertinent to pointing the optimal route to market, however, since it states that any transactions cleared via a CCP do not require any allocation of capital, according to Lombardo.

"People will have to find different ways to distribute their business streams if they want to stay in the game," said Lombardo, adding that sending trades to an exchange can also free up back offices to focus on more exotic trades taking place.

M&A uptick to drive demand for asset servicing and SBL

Mergers and Acquisitions (M&A) activity had solid growth in the second quarter of 2011, with EMEA in the double-digits, according to IntraLinks deal flow indicator.

Global activity was up 24 per cent year-on-year, which was consistent with key drivers such as an uncertain future over the state of sovereign debt. That has prompted companies to sell in fear of a less favourable economic climate or missing out on a fast rebound.

"The increase in M&A activity should help drive the demand for securities borrowing as arbitrage funds and investors look to exploit the imbalance in full-entity public company sales," said Matt Porzio, vice president of product marketing at IntraLinks.

"However, this effect may be tempered as we saw a larger rise in private and divestiture deals as overall activity increased from two previous quarters of essentially flat sequential performance."

Latin America had the greatest increase at 43 per cent quarter-on-quarter and 88 per cent year-on-year, large driven by growth in Brazil. There were also significant increases in manufacturing, energy and life sciences sectors compared to the previous quarter.

"As regions like Latin America and sectors like Energy and Life Sciences and Pharma showed significant growth in M&A activity in our Q2 Deal Flow Indicator, that will likely present opportunity for additional merger arbitrage and the associated securities lending as some of these deals become publicly announced in the next couple of months," Porzio adds.

"Like stock lending, asset servicing should see demand for services grow in a market where corporate actions, proxy voting and custody changes will rise as M&A deal flow demonstrated a strong second quarter but tempered by a larger rise in private sales and divestiture deals as overall activity increased," he said.

Oakpoint Advisors enhance services

Oakpoint Advisors has made its technology to negotiate and manage trading agreements and other contracts available to clients of Bloomberg Tradebook.

Oakpoint's software is designed to allow users to execute and transact a multitude of financing and trade agreements including prime brokerage, ISDA (International Swaps and Derivatives Association) and repurchase agreements. Users can readily access stored agreements or search for specific terms, at the touch of a button. This self-service model for contract management reduces legal expenses and hours spent searching for and filing agreements.

"Hedge funds of any size are required to negotiate, file and eventually access, documents and trade relationship agreements via secure channels," said Peige Katz, partner and head of Oakpoint Advisors' regulatory & compliance team. "With investors demanding more transparency, hedge funds - which are operating in a continuously changing regulatory environment - need an efficient and cost-effective manner in which to easily execute and implement such documents. By integrating our offering, Bloomberg Tradebook clients will have access to a simple solution to continuously track terms across multiple counterparties and contracts."

"Bloomberg Tradebook is committed to finding, vetting and providing solutions that allow our customers to spend more time on strategy and less on administration," said Raymond Tierney, chief executive officer and president of Bloomberg Tradebook. "Our customers expect us to move beyond basic execution services to a more consultative approach. Oakpoint's solution supports that new approach."

Quadriserv provides more securities lending data

Quadriserv, which operates the AQS securities lending platform, has expanded the data it offers on its websites.

Portfolio managers, hedge funds and trading desks that want to know how much the market is willing to pay to borrow securities will get a snapshot of market trends.

"This enables market players to better assess the rate at which their portfolios are being funded versus the AQS market," a spokesperson for Quadriserv said.

FFastFill becomes ISV at OneChicago

OneChicago (OCX) has announced that FFastFill is certified as an independent software vendor (ISV).

Ryan McElvogue, managing director of FFastFill, said, "The decision to reach out to OneChicago resulted in a direct response to customers' demand for access...The changing environment requires firms to look for more effective ways to participate in the equity markets."

As an ISV, FFastFill customer will have direct market access to OCX's fully electronic marketplace through the CBOEdirect API trade engine for order placement and related market data.

"FFastFill's unique pre-trade risk management together with their [application service provider] solution offers clients the ability to trade global markets locally," said Tom McCabe, CEO at OneChicago.

ASIC warns of securities lending disclosure for ETFs

The Australian Securities and Investments Commission (ASIC) has issued guidance to investors on risks associated with exchange-traded fund (ETF) products.

"ETFs are growing in popularity and people should understand the different features and risks of ETFs before investing," said ASIC Chairman Greg Medcraft.

ETFs are a type of managed investment that can be bought and sold like shares. They usually aim to replicate changes in the value of a share index, but are now also available for a wide range of assets including natural resources and foreign currencies.

The Australian regulator warned that securities lending practices should be outlined in the product disclosure statement for both physical and synthetic ETFs, on its MoneySmart website.

No US short selling ban

The US will not be following in the footsteps of four European nations which banned short selling activities last week.

An SEC spokesman said that safety triggers are already in place when a stock is experiencing significant downward pressures, wrote Bloomberg.

The short selling ban in France, Italy, Spain and Belgium followed curbs on the practice in Turkey, Korea and Greece as global markets plunged over economic growth and US and European debt concerns.

Research on the European short selling ban from Data Explorers (DX) shows that, throughout 2011, the average percentage of stock on loan for the stocks affected by the ban is below the market average in each country with the exception of Italy, where data are skewed by a very large outstanding loan. The data also suggest low institutional ownership of the named financial stocks, wrote Data Explorers. Among France-based companies affected were Societe Generale, AXA and BNP Paribas.

J.P. Morgan not in breach in AFTRA lawsuit

A federal judge in New York ruled on 5 August that J.P. Morgan did not breach its fiduciary duty of loyalty by investing in pension plans' and other entities' cash collateral in medium-term notes of Sigma Finance, while at the same time extending repurchasing financing to the company, according to Lexis Nexis.

The AFTRA Retirement Fund, along with two other pension plans, were lead plaintiffs in the two-year old class action lawsuit related to J.P. Morgan's role as a provider of securities lending services and its management of certain cash collateral on behalf of the Fund, according to AFTRA's website.

Separation of powers

In the first of a series, Anna Reitman examines the details of Finadium's Leading asset managers on securities lending, collateral management and custody 2011 report

ANNA REITMAN REPORTS

Among other securities lending industry trends, communication and reporting are cited as the most important drivers of quality service from an agent lender, according to an annual survey by Finadium, now in its fourth year. Optimism over the future of the securities lending industry as an asset class also punctuated the survey responses, which were drawn from interviews with 36 asset management professionals across 30 firms which cover $16.5 trillion in assets.

Notably, using custodians as the dominant service providers for some or all securities lending activity has declined over the last few years, at 60 per cent in 2011 compared to 83 per cent in 2008, while asset managers have largely adopted the practice of separating a request for proposal (RFP) for custody and securities lending.

"Separating custody and securities lending in an RFP appears to have cemented itself as an industry best practice," wrote Josh Galper, managing principal at Finadium and author of the report.

When making a decision to leave a custodian's lending programme, asset managers have been turning to third parties including other bank custodians to provide services. "The perceived benefits of a third party include higher service levels and more customisation," says Galper.

Meanwhile, custodians recognise this challenge and have been making efforts to provide greater customisation to their own programmes as well.

Northern Trust, which in the UK and Europe is known for its expertise in local government mandates, is an example of a custodian carving out a strong position in this environment. Recently, it was selected for a NOK 600 million (€76.4m) mandate by Baerum Kommune in Norway to provide global custody, securities lending, transition management and foreign exchange services for its municipal investment fund.

Meanwhile, boutique firms such as Albert Fried and larger operations such as Cantor have both invested heavily to compete for third party mandates and to meet current clients' demands, predominantly in North America.

For asset managers, the top three considerations in selecting a securities lending agent were: a bundled services offering (some combination of custody, fund administration and transfer agency services) at 41 per cent of executives, while 27 per cent of executives looked for corporate affiliation, with the same number citing effective client relationship management.

"Weighted by AUM, 44 per cent of the participating firms lend out at least some assets internally," writes Galper in the report. "All of these desks were set up years ago and are not growing in popularity; in our four years of surveying asset managers, we have never found a newly set up internal securities lending desk."

Still, participants are sanguine about the future of the securities lending market, with 90 per cent actively lending securities, compared to 75 per cent in 2009. Of that overwhelming majority currently engaged in a lending programme, all indicated an expectation to continue.

In addition, none of the managers reported ending a securities lending programme in that time and indicated it was likely that asset pools not currently lending would investigate a return over the next 12 months.

"Managers across different types of firms generally expect a better environment and improved margins for their lending programmes, and several noted investments made to support operations, reporting and risk management," Galper wrote.

However, managers from different kinds of firms had varied reasons for continuing lending programmes. Mutual fund managers indicated that securities lending continues to provide useful revenue for both returns and to offset expenses, and saw securities lending as a way to outperform their peers, especially for index funds.

Insurance companies responded that the relationship between securities lending and central credit counterparties presents an opportunity for advantageous arbitrage in the collateral upgrade trade, meaning securities that cannot be posted as collateral on a CCP are exchanged for eligible government securities or cash, wrote Galper.

US insurance companies favour corporate bonds for their investments, leaving some firms with insufficient cash or treasuries to post on a CCP as new OTC derivative clearing rules come into effect.

"Insurance companies are large users of OTC derivatives for hedging their portfolio risk, while mutual funds and other asset managers are not. Life insurance companies in particular have portfolios based on the annuities they owe to their policy holders and are managing their assets to their liabilities, whereas long or short asset managers have no such built-in liabilities," he added. **SLT**

Big Interview

Dev Outlaw, director of fixed income at the Texas Municipal Retirement System talks to SLT about how his views on the market have developed

ANNA REITMAN REPORTS

IMN's annual conference in Scottsdale, Arizona earlier this year attracted a standing room only crowd.

As one of the many beneficial owners in attendance, The Texas Municipal Retirement System's (TMRS) Dev Outlaw came to hear experts discuss the securities lending market. TMRS provides retirement, disability, and death benefits to employees of 842 participating cities and, as of 2010 year-end, the statewide agent had over 140,000 employee accounts, and over 38,000 retired members.

SLT: What prompted you to take a closer look at securities lending?

Dev Outlaw: First, some important background about TMRS' investments. Prior to 2008, TMRS was entirely invested in high grade fixed income instruments for an income-based strategy. The TMRS pension plan design prior to 2008 did not allow the crediting of unrealised gains to member or city accounts and the income-based investment strategy was appropriate for the plan. TMRS made its first equity investments in 2008 and, following the passage of legislation in 2009 that allowed the crediting of unrealised gains to employer accounts, moved to a total return strategy and expanded the diversification of investments.

That diversification will continue over the next few years. TMRS began its securities lending programme in 2003. With the income strategy in place at that time, securities lending potentially added incremental income to the portfolio.

SLT: How did you find the information presented in terms of making you feel confident pursuing securities lending?

Outlaw: TMRS attended the conference to expand our knowledge of the current issues affecting securities lending and to help us determine additional opportunities given our expanding diversification.

The key takeaway from this year's very informative conference was the movement toward risk reduction through focusing securities lending programmes more on the intrinsic value of lending instead of cash collateral reinvestment. This knowledge will influence TMRS' focus on the securities lending component of our custodial review in 2012.

Historically, we have incorporated securities lending as part of a bundled overall custodial service. However, we will be evaluating securities lending on both a bundled and unbundled basis in our planned 2012 custodial review.

SLT: Does securities lending make sense for TMRS?

Outlaw: Currently TMRS only lends to agencies and treasuries from our fixed income portfolio. No decisions on other asset classes or types of fixed income have been made. Our attendance at the conference was part of the research and fact-finding process that will culminate in recommendations to the Board at some future date.

SLT: How do current market conditions fit in with any decision on pursuing securities lending?

Outlaw: Diversifying our portfolio in the current market provides both challenges and opportunities, but our overall strategy has not been significantly changed by market conditions.

> Historically we have incorporated securities lending as part of a bundled overall custodial service. However, we will be eveluating securities lending on both a bundled and unbundled basis in our planned 2012 review

We think the entire sec lending market is challenged by the current low rate environment, especially in reinvestment of cash collateral. This is one of the key drivers of our desire to focus our sec lending programme on the intrinsic value of lending. However, the challenge TMRS currently faces is difficulty in finding consistent intrinsic value in the asset classes we currently lend, treasuries and agencies. We see potential opportunity in adding corporate and foreign bonds as assets to lend, however, we are reluctant to add to the reinvestment risk of our securities lending programme in the current environment.

SLT: How has your programme been adjusted in recent years and for what reasons?

Outlaw: TMRS' equity allocation is invested through commingled passive index funds and TMRS initially selected funds that were permitted to lend securities. In 2008, at which time the total equity allocation was approximately 7.5 per cent of the total portfolio, liquidity issues within the collateral pool surfaced. TMRS determined that the benefit from securities lending within those funds did not outweigh the liquidity risk, and so transitioned those investments to comparable but non-lending passive commingled funds.

SLT: What would you need to see happen to expand your securities lending activities to include other instruments such as stocks?

Outlaw: Market changes in cash collateral reinvestment risk or non-cash collateral opportunities would provide more incentive for us to expand our programme to add other assets. Also, working with our lending agent to adopt more conservative investment guidelines for TMRS cash collateral reinvestment strategies would provide additional incentive to expand the program. **SLT**

Dev Outlaw
Director of fixed income
Texas Municipal Retirement System

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HazelTree Treasury Suite: Selected Hedge Fund Profiles					
Fund Size	$500m	$1b	$1.5b	$3b	$6b
Long Exposure	90%	100%	100%	95%	110%
Short Exposure	80%	75%	110%	100%	85%
Avg. Credit Cash Balance	15%	10%	10%	10%	5%
Avg. Debit Cash Balance	10%	5%	15%	15%	12%
% Longs Hard to Borrow	10%	5%	7%	7%	5%
% Shorts Hard to Borrow	30%	30%	25%	20%	15%
Typical Treasury Impact on a Fund					
Cash Management	$125,000	$125,000	$375,000	$750,000	$750,000
Stock Loan Management	$900,000	$1,000,000	$2,100,000	$3,990,000	$19,800,000
Stock Borrow Management	$1,180,000	$2,212,500	$4,331,250	$6,900,000	$8,415,000
Total Performance Increase	$2,205,000	$3,337,500	$6,806,250	$11,640,000	$28,965,000
Impact in Basis Points	44.10	33.38	45.38	38.80	48.28

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Austria

Though securities lending activity has stalled in Austria, as has the country's economic recovery, the market appears due for a boost.

ANNA REITMAN REPORTS

The Austrian economy's recovery has started to sputter. As a whole, GDP is expected to rise 3.1 per cent this year. However, this is a reflection of a strong first half followed by a slump, according to Bank Austria's latest business indicator report, which notes that dampened consumer and industrial sentiment persist, and that foreign trade, which had fuelled the upturn to this point, has lost momentum.

"Economic sentiment has worsened across the board during the summer...both consumers and industry alike are taking a less optimistic view of the coming months," wrote Walter Pudschedl, economist at Bank Austria.

And the outlook for 2012 shows an expectation of GDP growth under two per cent on the back of volatile international conditions that will "burden Austria's economy".

In other words, after pre-crisis levels were reached in many areas, it is becoming clearer that there is not enough momentum for a lasting upswing as the eurozone debt crisis, the US fiscal outlook and bearish market sentiment take hold. In addition, consumer sentiment turned downwards in Germany, Austria's largest trading partner.

One of the bright spots in the economic outlook was an optimistic labour market – Austria, with a population of about 8.5 million, added 30,000 people to the working ranks during the first half of the year - but the trend has been reversing since April, writes Bank Austria.

Moreover, a one per cent hike in inflation is hampering any recovery and it is expected to stay over three per cent in the coming months, adds Bank Austria.

Though this evidence points to faltering business confidence, at the same time, investment growth is expected to continue throughout this year at a "more or less stable rate of a little below one per cent quarter-on-quarter, wrote Pudschedl. For 2011 as a whole, Bank Austria forecasts more than seven per cent growth year-on-year in terms of gross fixed capital formation.

"The mood in the industry...is still good, a further expansion is planned and necessary as during the 2008/2009 crisis investments were postponed and the revival started late and slow," he wrote, adding that the pace of investment recovery is not anticipated to be very fast.

Despite the gloomy mood, certainly not unique to this European country, Austria gets top scores for global competitiveness. The World Economic Forum ranks it 18th of 139 economies overall and sixth for business sophistication in its Global Competitiveness Index (GCI) 2010/11.

However, in terms of financing through local equity markets, Austria's ranking drops to 58th in the GCI.

Part of the reason for this might be because some aspects of securities financing, such as securities lending, though regulated and practised, is not offered by the Central Depository and there is no lending pool in the market. If needed, an investor has to agree with his custodian bank if such services can be offered, according to a UniCredit country profile.

The Austrian financial regulator, the Financial Markets Authority (FMA) explains that, with regards to securities lending within UCITS funds, especially within ETFs, three supra-national bodies – the Bank for International Settlements (BIS), the International Monetary Fund (IMF) and the Financial Stability Board (FSB) – have indicated serous concerns. Particularly in the context of "counterparty risk and abuse as a cheap refinancing tool for illiquid assets".

The FMA indicates that it shares these concerns and will closely work with the European Securities and Markets Authority (Esma) to find appropriate measures to avoid and mitigate systemic risks in that particular area.

With regards to the Vienna Stock Exchange, which enforced a general ban on short selling transactions for trades executed on the exchange, the regulator presumes that "securities lending is performed to avoid the prohibited uncovered short sales", and though the FMA states that it has not verified the information, market participants indicate there is no liquid lending pool in Austria.

In the domestic market, Austrian equities currently have 173 million shares out on loan worth $2.5 billion and inventory stands at 453 million shares worth $8.7 billion, according to Data Explorers, while market utilisation stands at 15.7 per cent, reflecting that Austria is the most heavily borrowed European equity market though this is probably due to lack of supply. The most borrowed stocks, according to its data, are Immofinanz, Intercell, Conwert Immobilien Invest and Wienerberger with with between five and nine per cent of shares on loan respectively.

One of the reasons that the Austrian domestic market is so small, is that consolidation has led banks to move their securities lending desks to other regions, for example Bank Austria moved its desk to Munich after becoming part of the UniCredit Group, according to a local trader. Meanwhile, funds are looking outside Austria for trading, he adds.

That means equity financing is dominated by a few players, such as Raiffeisen Bank International (RBI), one of the Austrian banks selected for the most recent European bank stress tests. RBI remained well above the five per cent threshold for its tier one capital ratio in the adverse scenario, at 7.8 per cent, ranking it among the top half of all 90 participating banks across Europe.

Though the domestic market is undeniably small, Austrian banks are well-integrated internationally, says Eugen Puseizer, head of rates at RBI, emphasising that cross-border trade is the prevailing means of business, amounting to between €1 and €2 billion average outstanding volumes at the bank depending on the season.

As opposed to more insulated countries like Israel, the Austrian market is without barriers and not as such a domestic business, except when borrowing securities, he explains, adding that major players in this respect are the larger asset managers such as Raiffeisen Capital Management (RCM), which, along with a number of other asset managers, are the main providers of stock to Austrian banks.

In terms of the wider Western European securities lending market, Puseizer notes that rules are well harmonised and the country follows international legal frameworks such as the Overseas Securities Lending Agreement (OSLA) and Global Master Securities Lending Agreement (GMSLA).

However, a boon to participation, he says would come from better integration of the Central Eastern European (CEE) securities lending market, where RBI has been traditionally involved.

"We face a lot of homework to be done in those countries, like Romania or Russia, where legal issues are not fully sorted out yet, there is still a netting issue and harmonisation in this region would definitely result in more participants in the market, as well as a much better supply of stock," Puseizer says.

In the same vein, a central depository would increase market participation, but the question is, he says, how and to what extent. Puseizer argues that an international central depository accepted by national banks in Europe would simplify settlement procedure significantly and, though Clearstream or Euroclear operate as central custodians, there is no infrastructure in place which works in all European countries.

At the same time, on the bond financing side, he is optimistic about an "encouraging" project being conducted by European central banks which will allow ECB eligible bond tenders irrespective of where they are held. "If this becomes effective, it will be helpful because it would no longer be a requirement to place ECB eligible bonds with the local central bank...this will be an effective instrument for the securities lending industry when conducting tender activities," he says.

Though there are no particular restrictions in Austria placing barriers on securities lending, there are some prohibited shorts with regards to banks, as there are in most countries in Europe, as regulators place bans on the practice in a bid to maintain asset prices in the financial services sector.

If there is a restrictive law unique to Austria, he notes, it is associated with mutual funds, which prohibits those mutual funds that are public funds to lend more than 30 per cent of their total assets. Compare this to Germany, where the limitation is that no more than 10 per cent can be borrowed by any one single counterparty, though the entire portfolio can be loaned.

"[The German mutual fund rules] allow [fund managers] to utilise the total assets...and the risk is spread...this provides additional liquidity and an additional source of income for the fund and I don't believe it is much riskier," Puseizer says.

From RBI's vantage point, the securities lending market at the moment is showing less activity, surprising considering the bearish mood. There is even flattened demand with respect to government bonds, though in general ECB eligible securities are increasingly being used for financing needs.

"It is worth mentioning that we have been facing quite a rise over the last few months in activity in government bonds, which is understandable under the current circumstances," Puseizer says. "Asset managers have been approached to a much higher extent by borrowers requesting government securities."

He notes that aside from the current crisis, this increase is the result of Basel III regulations, which will require banks to have a greater portion of holdings in the safest assets, among them ECB eligible government bonds.

"People on [trading desks] are not particularly well informed about the impact on their business [of Basel III]...maybe the controlling units know exactly what is going to happen, but talking trader-to-trader, I have been quite surprised that there is not much interest or knowledge about the details of Basel III...particularly in terms of liquidity," he says. "Definitely the business models of securities lending will have to be adopted if not significantly changed."

Puseizer reckons that cash collateral will become more expensive and thus, less frequently used, while the size of up and down grade trades will be done on a much larger scale compared to the levels today as such trades are balance sheet neutral.

This too is in light of the fact that Austria has introduced a bank tax which poses a "significant competitive disadvantage" for the country's banks, as the tax is related to the size of the balance sheet, also true for countries like Hungary and Switzerland.

"Securities lending is a most important instrument to provide necessary liquidity into securities trading, to fix settlement failures and to generate an additional source of funding," he says, adding that because of balance sheet neutral transactions, the market is due for a boost in the future. **SLT**

Green beans

SunGard Astec Analytics' Andrew Shinn examines the curious case of Coffee Holding Co.

MARKET PERSPECTIVE

While investors short stocks that they believe will decline in value, it's often assumed that short sellers choose companies that they think are poorly managed. As the case of Coffee Holding demonstrates, however, there can be many reasons why a stock is overvalued, and it may have nothing to do with the competence of the company's management.

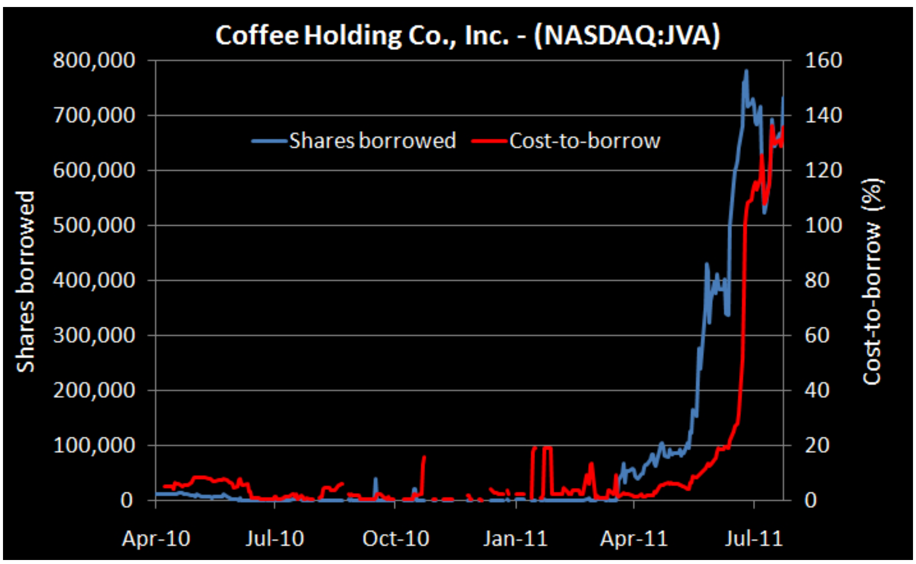
Coffee Holding Co., Inc. (NASDAQ:JVA) is a coffee wholesaler with its executive offices in Staten Island, New York, and its production facilities in Ohio and Colorado. Almost half of the company's revenue is generated by selling unroasted coffee beans to Green Mountain Coffee (NASDAQ:GMCR). Coffee Holding has benefited from the recent success of Green Mountain Coffee, including the announcement on March 11, 2011, that Starbucks would make its coffee available in Green Mountain Coffee's Keurig system.

Coffee Holding's stock price has averaged $5 for the past several years. Beginning in 2008 through to early 2009, the stock price declined from $5 to less than $1. From a low of $.60 on March 3, 2009, Coffee Holding's share price quickly rebounded to $4.24 on May 24, 2009. Even this increase of 600 per cent in three months, however, was less than the 630 per cent rise from $4.02 on March 9, 2011 to more than $30 on July 11, 2011.

Without conducting a survey of buyers and sellers of a stock, it's difficult to attribute a rise in share price to any specific cause. But it's safe to assume that the rise in share price on March 17 and 18, 2011 was related to Coffee Holding's announcement of record earnings on March 17. The company stated that it "double[d] net income as compared to the same period last year" due to its "horizontal integrated business structure combined with [its] hedging policies." While the price of coffee recently hit a thirty-year high, Coffee Holding's "cost of sales only slightly increas[ed] by 0.02 per cent." Coffee Holding's net income for the three months ending January 31, 2011, was $1,041,000, while for the three months ending January 31, 2010, it was $557,000. However, while the market reacted favourably to Coffee Holding's earnings release, if you take into account net gains from hedging, net income from recurring business actually declined from quarter to quarter.

The company has not always been so lucky when it comes to predicting the future of the commodities market. In the company's 10K for the period ending October 31, 2008, Coffee Holding announced a net loss of more than $2.5 million for the year. The company stated that "the decrease in net income primarily reflects hedging losses when the price of coffee surged to a 10 year high and subsequently collapsed during February and October 2008." Because the company does not have a great track record in the derivatives market, investors should not hope that Coffee Holding's luck with derivatives in 2010 and 2011 will continue.

While Coffee Holding's stock increased on March 17, 2011, from $4.45 to $5.95 after the company announced its earnings, the more significant stock price increase did not start until June 8, when the stock jumped from $8.50 to $12.14 in one day. Savvy short sellers who were aware of the non-recurring nature of Coffee Holding's earnings started shorting the stock en masse after June 8. Shares borrowed in SunGard Astec's Lending Pit system increased from 127,000 shares on June 8 to 429,000 shares on June 21. Short sellers who correctly picked up on the issue but shorted the stock prior to June 8 timed the trade incorrectly. If these early short sellers were lucky, they quickly exited the trade, because over the next month, the stock increased 147 per cent to over $30 per share.



While the stock never closed above $30, a director at Coffee Holding named Daniel Dwyer made a nice trade on July 11, 2011, and sold 700 shares at $30.54. Coffee Holding's CEO, Andrew Gordon, and his brother David, the company's executive vice president, did not time the market as well as Mr. Dwyer did, but the brothers sold 150,000 and 140,000 shares, respectively, at around $24. One wonders what the Gordon brothers were thinking as the market bid up what once was a $28 million market capitalisation wholesale coffee company to $165 million. The company's current market value is $85 million.

According to a roaster in Bloomfield-Hills, Michigan, who was quoted in a Crain's Detroit article on August 7, 2011 it's much harder for wholesalers and roasters to raise prices when selling to coffee shops than it is for coffee shop owners to increase the price of a cup of coffee to consumers. So there is an argument that wholesalers such as Coffee Holding need to hedge against coffee price increases. However, the case can also be made that wholesalers should not worry about hedging against price increases. In fact, this case is made by Coffee Holding itself. While the company has certainly benefited recently by hedging, the company routinely states in its SEC filings that "historically, we generally have been able to pass green coffee price increases through to customers, thereby maintaining our gross profits."

As it stands on August 23, Coffee Holding's share price is $15.33, almost 50 per cent off its July peak.

According to Astec's Lending Pit, shares borrowed on July 21, 2011 was 781,000. Over the next two weeks, short sellers returned 258,000 shares. However, since August 4, the number of shares borrowed has increased to 713,000, so short sellers believe that the shares still have further to fall. What this case demonstrates is that short sellers test anomalies. Sometimes they win, other times they lose, but short sellers should be considered a sanity check on over-excited investor sentiment. **SLT**

Andrew Shinn
Vice president, sales and development
SunGard Astec Analytics

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Upcoming industry events

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.

Sibos 2011

Date: 19-23 September 2011
Location: Toronto
Website: www.sibos.com

Sibos brings together influential leaders from financial institutions, market infrastructures, multinational corporations and technology partners to do business and shape the future of the financial industry.

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.

Collateral Management & Securities Financing Asia

Date: 21-22 September 2011
Location: Hong Kong
Website: www.collateralmanagementasia.com

Collateral management & securities financing framework is now a top consideration for Asian financial institutions.

16th European Beneficial Owners' Securities Lending Conference

Date: 26-27 September 2011
Location: London
Website: www.imn.org

For nearly 20 years we have been dedicated to meeting the needs of the European beneficial owner community and are proud to continue assisting beneficial owners in mapping a strategic course to navigate the opportunities and challenges.

5th Annual Collateral Management 2011

Date: 5-6 October 2011
Location: Barcelona
Website: http://finance.flemingeurope.com

The Fleming Group brings you Collateral Management, already in it's fifth year. Collateral managers from major European financial institutions will gather in the beautiful city of Barcelona to discuss latest trends and developments.

28th Annual RMA Conference on Securities Lending

Date: 10-13 October
Location: Naples, FL
Website: www.rmahq.org

RMA's Annual Conference on Securities Lending last year held in Boca Raton, Florida, rebounded from previous years and the effects of the unprecedented financial market events with over 425 SBL professionals from across the industry attended.

Data Explorers Securities Financing Forum

Date: 16 November 2011
Location: Hong Kong
Website: www.dataexplorers.com/hongkong

For nearly 20 years we have been dedicated to meeting the needs of the European beneficial owner community and are proud to continue assisting beneficial owners in mapping a strategic course to navigate the opportunities and challenges.

NeMa Asia 2011

Date: 15-16 November 2011
Location: Singapore
Website: www.informaglobalevents.com

NeMa Asia (Network Management Asia) - the sister event to NeMa, has now become the most important gathering of network managers, subcustodians and brokers in the industry.

Industry Appointments

Mehdee Reza has been appointed Asian head of prime brokerage at Morgan Stanley. He will take up the role at the end of next month and will move from his current position in London where he has worked in prime brokerage sales since 2005. "Mehdee's wealth of experience in Asia and specifically with Asia hedge funds will help ensure we continue to offer the very best services to our global and regional client base," said Alex Ehrlich, global head of prime brokerage.

Citi's global transaction services has hired **Sam Ahmed** as head of collateral management sales for Asia Pacific.

Ahmed will be joining Karim Chabane, hired earlier this year as product head of collateral services, and report to Pierre Mengal, regional head of collateral services for Citi in Asia Pacific.

"The growth in OTC derivatives globally has resulted in institutional investors and broker dealers looking to effectively mitigate credit risk...I am extremely excited by the opportunity that these appointments present in helping Citi grow its collateral management business," said David Russell, regional head for Asia Pacific at Citi Securities and Fund Services.

Ahmed joins Citi from Merrill Lynch in Singapore where he managed regional collateral management and derivatives client services teams for the private banking division.

Deutsche Bank has hired **Paul Winter** as the new head of collateral management and valuations.

Winter has 23 years of experience in financial services, specialising in financial derivatives and collateral management.

He was most recently the managing director at Chromozome Consulting.

Citigroup has appointed **Stewart Aldcroft** in the role of managing director and senior adviser for its Investor Services business. As a senior adviser, Aldcroft will help to develop new initiatives and grow Citi's client base and reach across the Asia Pacific region.

Aldcroft joins Citi from Enhanced Investment Products (EIP) where he was head of business development for beta products since May 2010. He will be based in Hong Kong, where he has over 25 years of experience in various fund management houses such as Schroders, HSBC, Franklin Templeton, Investec and Horizon21.

Aldcroft will report to David Russell, Asia Pacific head of Securities and Funds Services.

"Stewart brings...a deep knowledge of the asset management industry in Asia that will help us further enhance our focus in the Investor Services segment," Russell said.

Aldcroft has also been actively involved with traditional mutual funds, hedge and alternative investment funds, structured products and recently with Exchange Traded Funds (ETF).

HSBC Securities Services (HSS) has announced three appointments in **Asia Pacific** in its Client Management Group.

Hazel Lai, **Khalid Salim**, and **Sue Shim** have been appointed senior vice president, sales and relationship management for the Asia Pacific region and will be based in Hong Kong. Lai and Salim are responsible for providing services to global custodian banks and broker-dealer clients.

"We are delighted to welcome Khalid, Hazel and Sue to the team. These appointments further strengthen our Client Management Group in the Asia Pacific region drawing on both internal and external talent to provide service excellence to our clients," said Dan Massey, regional head of Client Management Group in Asia Pacific.

Shim is responsible for sovereign wealth funds as well as South Korean financial institutions. She joins from Citibank and has over 13 years of experience in the securities services industry in South Korea and Hong Kong.

Salim joins from Deutsche Bank with over 12 years experience in the securities services industry in Europe and the Middle East.

Lai joins from HSBC Payments and Cash Management where she was working closely with HSS broker dealer clients.

Redkite Financial Markets has appointed **Matthew Coupe** in the role of sales director. He joins the specialist financial markets surveillance firm at a time when global regulatory initiatives are driving market demand.

Coupe joins Redkite from FTEN, where he was director of sales, focusing on high frequency trading, real-time risk and execution systems. He is an expert in the post-MiFID regulatory landscape, how it has affected electronic trading and micro market structure and the implications for trading desks and compliance departments. Coupe has previously worked for Turquoise Execution Services, Ullink and Thomson Financial.

The appointment follows Redkite's recent investment from leading European VC firm DFJ Esprit.

Citi Global Transaction Services has announced the appointment of **Marcia Rothschild** as head of Latin America securities and fund services client and sales management.

Rothschild brings over 18 years of global industry and product experience, including senior positions in Brazil, Luxembourg and the United States.

"Marcia brings a keen understanding of client needs and will be instrumental in enhancing industry visibility for our products and ensuring clients and prospects have full access to our complete capabilities," said Alejandro Berney, head of Latin America Securities and Fund Services at Citi.

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Rothschild joins from BNP Paribas, where she was most recently the head of securities services in Brazil, and will report to Alejandro Berney, head of Latin America Securities and Fund Services, and Dirk Jones, global head of financial institutions client sales management, Global Transaction Services.

HedgeServ has appointed senior business development executive **Farnaz Milani** as managing director in its sales team. Milani will be responsible for building relationships with leading hedge fund managers, funds of hedge funds, private equity funds, and institutional investors. "Farnaz is a proven veteran in fund administration with an industry-wide reputation for integrity," said Justin Nadler, president of HedgeServ. "We enthusiastically welcome Farnaz as a significant addition to the HedgeServ team. Farnaz brings extensive experience in partnering with prime brokers, audit firms, and due diligence professionals and is a trusted resource to investment managers for tailoring complete fund administration solutions."