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China sec lending launch 'imminent'

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Speculation is swirling around media reports that Beijing is setting up a centralised securities lending exchange to deepen China's markets.

Citing unnamed officials and fund managers, the FT reported that the facility, which will be majority owned by the market regulator, may be up and running as early as the first quarter. The official Shanghai Securities News reported that China's securities regulator denied this was the case.

In October last year, market observers commented to SLT that after a consultation with large funds, the China Securities Regulatory Commission (CSRC) was looking to set up a finance company which could behave as a third party lending environment with a dedicated pool of securities, albeit with a firewall between securities brokerages and the set up.

At the same time, sources familiar with the market noted that China will take a conservative approach towards implementation because of a distrust of financial innovation after the Lehman crash and as Europe moves to curb the practice with various short selling bans.

China's State Council approved a package of measures for securities lending and futures index and margin trading as far back as January 2010, when the highly anticipated reforms began to progress. But as the eurozone crisis intensified, it stalled until late last year, when the CSRC extended a government-run pilot programme to allow a larger pool of brokerages access to securities lending practices as well as making entry thresholds lower.

There does indeed seem to be some momentum for reforms to continue to progress as China has expressed a desire to improve market liquidity. According to the FT, the new centralised lending exchange will make shares available to qualified fund managers in China who wish to borrow them for a fee, sourcing the shares from institutions in China including banks, insurers and fund management firms.

Aside from the CSRC, the Shanghai and Shenzhen stock exchange as well as brokerage firms and other financial institutions will be shareholders of the facility, it added.

NEWSINBRIEF

Russia's CSD launches securities lending

Russia's National Settlement Depository (NSD) concluded its first transaction as a securities lending agent between a brokerage firm and bank.

Using its "settlement REPO" technology of securities lending, NSD now offers customers the capability to fulfil clients' obligations to supply securities. Stocks were both loaned and posted as collateral to conclude the transaction.

Data Explorers reveals top 15 shorts of 2011

MF Global topped the list of shorted stocks in a look back at a year of market turmoil and underperformance.

Stock pickers have had a tough year - the equity hedge index has dropped over 19 per cent on the back of an unsupportive macroeconomic environment and political uncertainty on both sides of the Atlantic. Short sellers, on the other hand, have managed to stay on top of it and consistently identify shares which underperform, noted Data Explorers.

By analysing securities lending flow data, the research firm found that Asian, European and North American stocks were split evenly among the 15 top shorts, with five in the list from each region, however North America and Europe dominated the top half.

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INSIDE SECURITIESLENDINGTIMES

Data Explorers reveals top 15 shorts of 2011

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After MF Global, Thomas Cook took the second slot. The troubled travel firm hit a 52-week high in short interest in April and returns ultimately tumbled 91 per cent since. Sino-Forest, which was targeted by Muddy Waters for alleged accounting inconsistencies, saw a 79 per cent drop in returns since hitting its 52-week high in May. And another accounting scandal-hit company, Olympus, snuck in at the bottom of the list after tumbling 57 per cent since hitting a short interest peak for the year in July.

In order, the top 15 shorts are: MF Global, Thomas Cook, Banca Popolare Di Milano Scarl, AMR Corp, Pandora, Sino-Forest, Banco Comercial Portugues, Energy Resources of Australia, Human Genome Sciences, Eastman Kodak, Banco de Valencia, Chaoda Modern Agriculture, China High Speed Transmission, Peak Sport Products and Olympus.

"Whilst short sellers have profited from falling equity markets in the last year, our data shows that they were able to consistently identify shares which not only see price decreases, but fall more than market average. It will be interesting to see if short sellers are able to continue this performance in the year ahead," wrote Data Explorers.

Ireland's central bank lifts ban on short selling

The Central Bank of Ireland has announced the end of the ban on short selling of certain financial instruments, which has been in place since September 2008.

The decision follows the completion of Bank of Ireland's recapitalisation this year, the bank's spokeswoman Nichola Faulkner told Bloomberg BusinessWeek.

Bank of Ireland is 15 percent state owned while Ireland's other two remaining listed lenders, Allied Irish and Irish Life, are both more than 99 percent state owned and thus listed on the junior market, BW adds.

Citi sets up securities lending in Los Angeles

Citi has opened a securities lending office in Los Angeles to expand its OpenLend presence. The new members of its Los Angeles team bring extensive years of industry experience and will be responsible for product sales and relationship management for the mid-west and western regions of the US.

OpenLend is an open architecture securities lending solution that leverages Citi's global presence, robust risk management controls and innovative trading strategies to help clients achieve their performance objectives.

"Client satisfaction is at the core of our OpenLend offering," said Tim Douglas, global head of securities finance, Global Transaction Services at Citi. "Our new Los Angeles office will provide the on-the-ground presence we need to deliver premier service and respond faster to our expanding client base."

Norwegian banks fined for short selling violations

Norway's economic crime prosecutor has fined four finance companies NOK400,000 (€51,586) for allowing shares to be sold short before they were eligible for trading. The fines were accepted by all four companies.

Nordea Bank, First Securities (currently Swedbank First Securities), Fondsfinans and Svenska Handelsbanken were reported by Norway's financial regulator, Finanstilsynet, in June last year following a stock dilution by an Oslo-listed subsea oil and gas support services company. The regulator uncovered the trades in connection with a share sale by Reservoir Exploration in April 2010 when the company issued 2.4 billion shares from 400 million.

It found that many investors had started selling the shares at a considerably higher market value based on the number of outstanding shares prior to the restructuring of the company and before the new shares were "tradable". Consequently, sellers who sold short made a large profit they were not entitled to, explained Hans Christian Koss, public prosecutor at OKOKRIM, Norway's economic crime unit.

"Banks have a responsibility to make sure that investors own their shares before selling them and need to check that out more firmly than they normally do in some circumstances. In this case, they violated their duties by continuing to sell without asking necessary questions to investors," said Koss.

Bio-med firm takes on short sellers

Ampio Pharmaceuticals believes that increased volatility and volume in its common stock was a result of factually inaccurate and purposely misleading information being published on the internet.

Dramatic short selling which drove down Ampio's share price was reportedly spurred by funds and individuals on Wall Street. The coordinated attacks were believed to be part of a bigger effort by numerous individuals who had taken large short positions in the stock in anticipation of a "leaked" financing that was rumoured to have been announced.

According to Bio-Med Reports, recent data shows nearly a six per cent increase in short interest with as much as 12.9 per cent of the stock's float now positioned to the down side. In addition, the short sale volume in the stock rocketed to 25.7 per cent shortly after a sharp drop in the stock's price. Nasdaq officials who were contacted about the situation directly by Bio-Med Reports would say only that they have been closely monitoring the situation.

Ampio officials stated that they are investigating the claims that were made and that they intend "to take necessary legal measures to protect officers of the company and its shareholders".

Investment advisory website, Seeking Alpha, admitted on its website that the substantial criticisms of Ampio a recent published article had made, proved to be "quite poorly researched".

More securities lending info required - Fed

More data is required to monitor repo and securities lending markets to inform policy makers and researchers about firm-level and systemic risk, according to the Federal Reserve Bank of New York.

"Better data is particularly important for understanding repo and securities lending markets and monitoring developments that may be indicative of stress. Such early warning signals can be the basis for policy decisions that aim at stabilising the financial system," the US regulator wrote in a recent staff report.

Although recognising the important role of securities lending markets for allowing shorting of securities, at the same time, the Fed noted that both repo and securities lending markets are exposed to the drying up of liquidity which can create systemic risk from runs on the markets as happened during the financial crisis.

The repo market experienced such liquidity shortages in the week prior to the Bear Stearns crisis, while the securities lending portfolio in Maiden Lane II - formed to purchase RMBS from the US securities lending reinvestment portfolio of AIG subsidiaries - illustrated the risk in liquidity mismatches of securities lending.

The report concluded that six shared characteristics of repo and securities lending trades need to be collected at the firm level: principal amount, interest rate, collateral type, haircut rate, term structure and counterparty information.

Options trader pays $2 million for illegal short selling

An options trader in the Chicago area agreed to pay more than $2 million to settle SEC charges alleging he violated the "locate" and "close out" requirements of RegSHO.

According to the SEC, Gary Bell improperly relied on a market maker exception because he was not engaging in "bona-fide market making activities" in the securities he was borrowing.

George Canellos, director of the SEC's New York regional office, said, "Bell avoided the cost of borrowing shares while engaging in complex short selling transactions, thus earning significant profits with minimal risk and gaining an advantage over legitimate participants in the market. We'll continue aggressively to pursue and punish abusive short sellers who attempt to circumvent regulatory requirements to make more money."

The SEC found that Bell effected illegal naked short sales from December 2006 to June 2007 while working as a broker-dealer himself and then later as the principal trader at Chicago-based broker-dealer GAS. The transactions in question created the false appearance of compliance with the requirements of US regulation RegSHO, while in reality there was no delivery of shares.

Bell has settled the SEC's administrative proceedings without admitting or denying the US regulator's findings.

NYSE reports December drop in short interest

NYSE Group reported short interest as of mid-December fell to 13.5 billion shares, which represents about 3.5 per cent of total shares outstanding. Based on information received from members and member organisations, short interest decreased by some 735.5 million shares since the end of November.

Of the 4,516 stocks and 48 warrants available for trading, 3,772 issues had either a short position of at least 5,000 shares or a change of 2,000 shares since the last monthly report.

NYSE Group's semi-monthly file contains the reported uncovered short positions of securities listed on NYSE, NYSE Arca and NYSE Amex.

FINRA fines Credit Suisse $1.75mn

FINRA has fined Credit Suisse $1.75 million for violating RegSHO and failing to properly supervise short sales of securities and marking of sale orders.

As a result of these violations, Credit Suisse entered millions of short sale orders without reasonable grounds to believe that the securities could be borrowed and delivered and mismarked thousands of sales orders.

The US short selling regulation, RegSHO, requires that firms obtain and document this "locate" information before the short sale is entered, thereby reducing the number of potential failures to deliver in equity securities. In addition, brokers and dealers are required to mark sales of equity securities as long or short.

Brad Bennett, FINRA executive vice president and chief of enforcement, said, "Credit Suisse's RegSHO supervisory and compliance monitoring system was seriously flawed. Millions of short sale orders were being entered in its systems without locates for over four years because the firm did not have adequate Reg SHO technology and procedures in place."

In concluding this settlement, Credit Suisse neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

Penson to close UK arm

Penson Worldwide has announced plans to close its UK operation over the next few months, and to sell certain of the operation's assets to third parties.

Exiting the UK local clearing market was one of the company's previously announced strategic objectives to reduce costs and debt, and improve profitability. Penson Financial Services Ltd (PFSL) of London is currently running at an annual loss of $6-$7 million.

PFSL has approximately 25 correspondent customers, 60 employees, and $8 million in net revenues. It was accounted for as a discontinued operation in Penson's results starting in the third quarter of 2011.

Penson said that after lengthy negotiations with several leading financial organisations, it was unlikely a sale agreement of PFSL as an operating entity would have been reached in a timely manner.

Markit and Euroclear sign memorandum of understanding

Markit and Euroclear Bank have signed a memorandum of understanding to jointly create an operational infrastructure to support the use of loans as collateral in financing transactions. In parallel, Markit and Euroclear Bank intend to collaborate on introducing a series of other services to enhance transparency, automation and trade settlement for the European leveraged loan market.

To enable the use of loans as collateral in financing transactions among trading counterparties and central banks, Markit will provide loan pricing and other market data to make it possible for Euroclear Bank to extend its pool of collateral to include loans in triparty collateral management transactions. Scheduled to be deployed in 2012, the joint service will increase refinancing possibilities for loan portfolios and diversify bank funding sources.

Other services planned by Markit and Euroclear Bank for the loan market include:

- the integration of Euroclear Bank's delivery-versus-payment settlement services with Markit ClearPar and Markit Clear, Markit's electronic platforms for loan trade settlement;
- a new asset servicing platform for syndicated loans that links Markit's loan messaging hub for agents and lenders with Euroclear Bank's expertise in event reporting and payment execution; and
- the use of Markit data to expand reconciliation services available through Euroclear Bank's LoanReach platform.

Joe Widner, managing director and global head of loan processing and portfolio management at Markit, commented: "We are excited about partnering with Euroclear to develop innovative services and technology to improve liquidity and introduce new opportunities to the European loan market. Our shared goals are to help the market grow through new solutions such as using loans as collateral, and to reduce risks and inefficiencies by automating trade and cash settlement."

Jo Van de Velde, managing director and head of product management at Euroclear, added: "Financial institutions around the world will in-

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creasingly look at their loan portfolios as one of the means to obtain stable funding at attractive rates. Euroclear Bank's existing LoanReach and triparty collateral management services, together with Markit's loan products, will expand the pools of collateral available to our clients by including a new asset class. "

We are very excited to have found in Markit a partner with a unique franchise and proven track record in the syndicated loans area. Our respective services are complementary and even stronger when offered jointly."

Lombard acquires reg reporting business of SOFGEN

Lombard Risk Management has acquired the regulatory reporting business of SOFGEN for US$4,250,000 payable in a combination of cash, loan notes and equity.

The acquired business is profitable, and in addition the Board expects appreciable revenue synergies over and above the sum of the two businesses at present.

The main part of the business acquired, which in the past was known in the US regulatory market as IDOM USA, is the United States and Canada regulatory reporting product REG-Reporter which has a strong client base in North America including banks such as Bank of America and Royal Bank of Canada.

The transaction will make Lombard Risk:

- The top provider of regulatory reporting products to foreign banks in the United States
- The third largest provider (as measured by assets reported on, not number of institutions) of regulatory reporting to domestic banks in the United States after FIS and Jack Henry
- and with a bigger presence than all of Lombard Risk's international competitors combined.

The combined business now has over 250 clients for bank regulatory reporting around the world. Lombard Risk has the largest market share of any regulatory reporting product used by banks in the United Kingdom – with around 130 UK clients.

As well as the UK and the Americas, Lombard Risk also has coverage of Asia Pacific markets with regulatory reporting solutions in use in Singapore, Hong Kong, Japan, Indonesia, Thailand and other Asian countries. Lombard Risk recently announced a contract win for Chinese regulatory reporting, and has Indian and Korean regulatory reporting under development.

Commenting on the acquisition, John Wisbey CEO of Lombard Risk said: "This is an important strategic breakthrough for us, as it gives critical mass in the North American market place, both for foreign and domestic banks in the United States. We already had this for collateral management but we now have it for regulatory reporting. The REG-Reporter business and its management are well respected in the market, and it has built an impressive and very loyal client base. As the market moves away from having multiple suppliers in different countries, this acquisition will allow us to serve our global clients better with much more ability to conclude deals in multiple countries and continents. We understand this business and its business model extremely well, so we are absolutely 'sticking to the knitting' with this acquisition."

EFPs and blocks up 43% in December announces OneChicago

OneChicago announced that EFPs and blocks in December 2011 were up 43 per cent at 489,584 traded compared to the previous month. EFP activity represented more than $2.7 billion in notional value.

335,589 December 2011 futures valued at more than $1.3 billion were taken to delivery, emphasizing the use of single stock futures as an equity finance product.

Open interest stood at 351,379 contracts at the end of December, of which 28 per cent was OCX.NoDivRisk products. The OCX.NoDivRisk product suite is an equity finance tool which removes dividend risk from the security futures. Contracts on the equity finance exchange for the fourth quarter of 2011 increased four per cent versus fourth quarter 2010.

OCC stock loan programme up

OCC's total cleared contract volume in 2011 reached 4.6 billion contracts, a 17 percent increase over the 2010 volume, marking the ninth consecutive year of record volume for the clearer.

OCC's annual securities lending activity was up 42 percent from 2010 with 743,730 new loan transactions in 2011, ending the year with an average daily notional value of $19.1 billion.

In the last month of 2011, however, new loan activity fell to 45,133 transactions, a drop of 35 percent compared to December 2010.

Eurex Group reports 2011 trading volumes

Total trading volume at Eurex Group in 2011 was at 2.8 billion contracts with average daily volume of 11.1 million contracts, an increase of seven per cent over last year.

The Eurex KOSPI Product had the highest growth rate while Eurex Repo saw a significant increase in volumes over the year.

At Eurex Exchange, the equity index derivatives segment was the largest in 2011 with a total volume of 954.7 million contracts, up from 805.1 million in 2010. Derivatives on the EURO STOXX 50 index were the largest single product with 408.9 million futures and 369.2 million options.

The equity derivatives segment (options and single stock futures) saw 449.6 million contracts, down from 511.1 million in 2010.

Eurex Repo, which operates CHF Repo, Euro Repo and GC Pooling markets, continued to grow in 2011. The secured money market GC Pooling hit a new record with an average outstanding volume of 118.2 billion euros, an increase of 29 per cent y-o-y; the Euro Repo market totaled at the new peak of 148.5 billion euros, an increase of 30 per cent.

In December 2011, the GC Pooling market grew 27 per cent y-o-y and reached 140.4 billion euros; and the Euro Repo market recorded an outstanding volume of 174.7 billion euros, an increase of 31 per cent.


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Extending surveillance

Wolfgang Fabisch, CEO of b-next, discusses the needs clients have for short selling market surveillance and the trends he sees developing in the space

ANNA REITMAN REPORTS

For over 20 years, b-next has provided complex trading surveillance and compliance across all venues and asset classes. Though focused on German-speaking European countries, with clients such as the German regulator, BaFin, exchanges and banks, the vendor is now branching out into the UK first with clients and with others, such as MTFs, in the pipeline.

Using a modular approach, b-next's clients, some of which perform hundreds of thousands of transactions per day, can get "cockpit" applications, allowing them a graphical view across silos in order to interpret market behaviour while flagging trouble spots.

SLT: Can you tell me about b-next's short selling market surveillance module?

Wolfgang Fabisch: Short selling was a very hot topic in Germany about 16 – 18 months ago, when there was the first short selling ban on certain bank securities and we became one of the first companies offering a solution for short selling avoidance. Getting real-time data is a challenge for companies to see if they do hold securities or equities of an instrument. They need to ask the question, "do we have these instruments in our books or not?" "Are we short selling these instruments or not?" It is one of the most difficult problems in the market because the instrument may be in different books within the company, so people need to have a different view over different silos.

The system will inform you if you are selling a banned stock short and then there are options to handle the problem.

Possibly the decision will get made to sell a smaller quantity or, if there is more of the stock in another book [the system] can find it. But it will stop the organisation from being short at the end of the day.

SLT: Apart from the short selling bans, which regulations are you hearing about most from clients?

Fabisch: We get a response from the market on the Market Abuse Directive II [which will regulate financial instruments as defined under MiFID and cover exchanges, OTC and MTF trading venues].

We understand that the regulators in the UK and Germany, but also in France, Italy and Spain are going to be very tough in looking after this regulation, it is a big influence in the market at the moment. I don't see much response on MiFID II although I do see market participants looking at Dodd-Frank, but I don't think it will influence the market until the second half of 2012. Still, there is concern over regulatory paperwork for those companies doing business in the US for example.

SLT: In developing market surveillance tools for short selling, do you participate with the securities lending industry?

Fabisch: Not yet, we are working here in Germany with some of our customers who are a part of that community, but as a company we don't have any partnerships.

One notable development though is that we are offering our applications out of the cloud. This is important for medium sized or small companies in the community because it does mean there will be a cost reduction on the regulatory side. They will not have to have their own hardware platform or pay large sums for upfront investment in getting the software for doing their compliance and market surveillance function. For this, we use the Thomson Reuters Elektron platform as the medium to deliver our application to the industry. This is one of the most important things we are doing now and I think it will develop very fast.

SLT: What are some of the notable successes customers have had using the short selling market surveillance module?

Fabisch: I can give you one example, which has nothing to do with any specific fraud. One of our customers many years ago, came back to me saying that he is earning back the costs of the system in two weeks because it catches so many fat fingers.

He put the number at an earning of around ½ euro per transaction after doing the calculation for all the transactions he had and the thousands of euros that would have been lost if the fat fingers were not found.

Using our system, our customers are catching things that are going wrong though these might not be criminal activities. Very often, market surveillance people are going back and saying, we are taking a higher risk on this transaction than we want to take. It may not be the volume or amount of the transaction, but the premium that a dealer may want to put on a stock is higher than the risk policy allows because they believe their strategy will earn more than the cost. So, market surveillance can look after their dealers and make sure they are in line with the risk taking policy.

SLT: What do you think are the most significant trends from the vendor's point of view?

Fabisch: What I hear from the market when I am talking to our customers and our prospects is that they are fed up of regulatory stuff. It is a driver we need, but the reaction is that they don't like it and want to spend as little as possible on it.

More and more though, our customers understand there is another side of the matter, there are these fat finger problems I talked about, there are these risk policy things, there are operational risks they need to be aware of and at the moment they do not want to take reputational risk any higher.

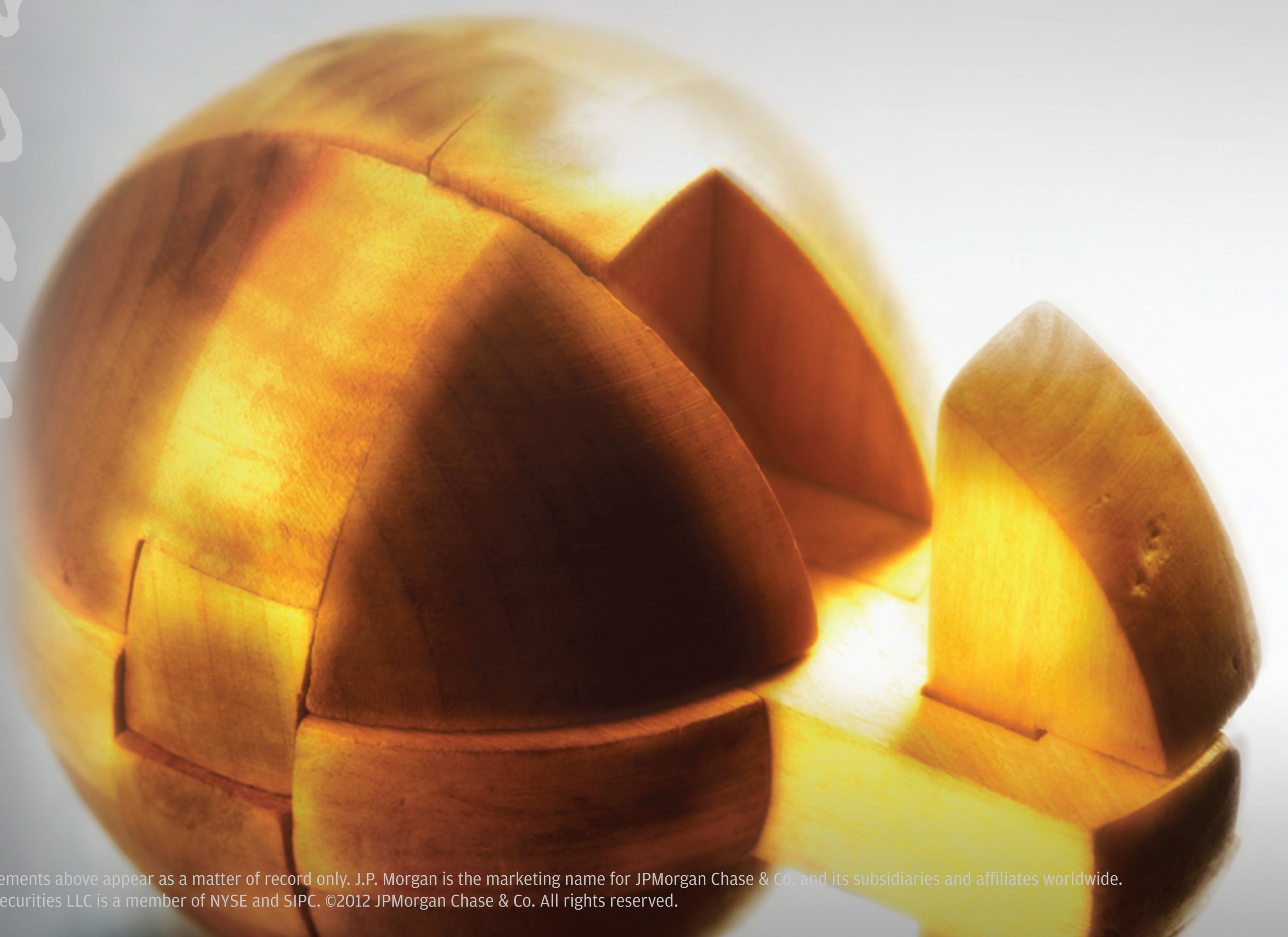
There is more of a risk avoiding approach in the market. People want to understand - where are the risks in my business, which ones do I want to take, and where do I want to lower my risk? It is a precision approach that is developing.

Another trend I see coming down is that surveillance will become more real-time than it is today or at least near time. I know many institutions which are doing their surveillance on a monthly or weekly basis, now many of them are coming to daily market surveillance they are looking for T+1 - business they did yesterday, they are looking at it today. With market abuse scenarios, they have to get closer to the transaction time so I think we will see market surveillance within hours or even minutes. In some cases, like with algo or high frequency trading, we will have to go down to seconds.

I think many people understood that HFT and algo trading are exciting developments but also dangerous, as we saw in the [May 2010] flash crash and that we have to find rules and tools to manage this risk as well. **SLT**

Wolfgang Fabisch
CEO
b-next

Using our system, our customers are catching things that are going wrong, though these might not be criminal activities



Luxembourg

Despite the economic clouds hanging over Europe, Luxembourg is well prepared to grow its securities lending industry

ANNA REITMAN REPORTS

Despite a deteriorating eurozone outlook eating away at Luxembourg's financial services industry, bright spots are on the horizon.

As the second-largest investment fund centre in the world and the largest in Europe, Luxembourg's financial sector continues to adopt European Union regulation early, which is helping to draw in hedge funds, particularly those adapted to operate within the UCITS framework. By mid-2011, over 3,700 hedge funds were registered, a total exceeded only by the UK and France.

> One notable peculiarity of Luxembourg's regulation involves the level of collateral required to protect securities lending transactions. The minimum is set at 90 per cent of the global valuation of the securities lent

The size of Luxembourg's UCITS sector is now a major attraction for hedge funds moving into Europe to earn credentials for eventual distribution beyond the EU while the country's low public debt and relatively stable economy present advantages in attracting investment fund flows albeit with fierce competition from Ireland, the Channel Islands and even Malta.

Its success as a financial centre, says agency Luxembourg for Finance, is grounded in the social and political stability of the Grand Duchy and in a modern legal and regulatory framework that is continuously updated, allowing it to offer a wide variety of investment fund vehicles. It is also at the top of the World Economic Forum's global competitiveness index for the prevalence of foreign ownership of companies.

But an impending recession in Europe, and resulting slowdown in demand from the eurozone will dampen exports, with financial services, which accounts for some 28 per cent of GDP according to some estimates, suffering most.

And the outlook for GDP growth over the next year has weakened further, notes Ernst & Young in its most recent economic report on the country. The firm has heavily revised its forecasts for growth – to 1.9 per cent compared with 3.5 per cent in an earlier report. For 2012, it predicts 0.9 per cent growth, revised down from 1.7 per cent.

The revisions take into account that the economy took a much larger hit from the global crisis than previously calculated while the greater than expected intensity of the eurozone crisis too is affecting future growth prospects.

That has certainly spurred officials, such as the finance minister, trade minister and Grand Duke, to market Luxembourg as Europe's financial centre to high-growth regions such as China and South East Asia. Relocation of offshore funds and gradual recovery of eurozone financial markets will undoubtedly support financial sector growth but sustaining net inflows in the longer term will require tapping into rising savings flows from East Asian and Middle Eastern emerging markets, notes Ernst & Young.

A more near-term bright spot is the push to derivatives clearing. Alternative investment funds that will now need centralised derivatives trading may be encouraged to relocate to Luxembourg because of its early moves towards an ECB-linked securities repository. In October, Clearstream announced that its joint venture, LuxCSD, with Luxembourg's central bank became fully operational and will serve as the access point to TARGET2-Securities (T2S).

LuxCSD provides the Luxembourg financial community with central bank money settlement prices as well as issuance and custody services for a wide range of securities, including investment funds.

In the securities lending space, the company has two programmes: ASL supports settlement and is an agency lending programme in which Clearstream acts as guarantor to anonymous trades and ASL+ offers strategic lending to custody clients to earn additional revenue with Clearstream acting as a principal lender.

Currently, only fixed income is available for securities lending activities in Luxembourg until next month, when Clearstream will add equities to the programmes.

Borrowers are the large investment banks in Europe and the US and prime brokers and lenders are Clearstream's custody clients such as central banks, corporates and custodian banks. Often depository banks will choose Clearstream's services as opposed to developing their own securities lending business or going to other competitors.

Jean-Robert Wilkin, head of product management for Global Securities Financing at Clearstream, oversees the securities lending business in the ICSD in Luxembourg and CSD in Germany as well as collateral management services across the operations.

"As an ICSD, we are in a very specific and privileged position because we are both acting as a lending agent for the lender, but also as collateral agent for the lender and the borrower out of our triparty programme. So we run a very conservative programme which makes it more secure for ourselves and the lenders," Wilkin says.

He notes that most securities lending activity for the large pool of assets domiciled in Luxembourg is not generally done in the country, instead traded across major lending desks in London, Paris or Frankfurt. Their own programme, ASL+, is operated out of a trading desk in London.

GSF Summit

In the run-up to the Global Securities Financing Summit, Wilkin expects collateral management to continue to be the hot topic as lenders are increasingly concerned about counterparty risk. Luxembourg's regulator, the Commission de Surveillance du Secteur Financier (CSSF), has done well to make legislation on liquidation of collateral and protection of the lenders transparent, he says, adding that though many European countries fall under the same EU directives, not all countries have adopted national legislation with the same clarity equally.

Luxembourg's most recent legislation on securities lending, Circular 08-356, also leaves the field open for a wide variety of collateral to be posted to secure transactions and, while eligible collateral in the form of AAA government debt continues to diminish, diversification is likely a coming trend for the securities lending space, says Wilkin.

> There is not enough transparency around what the applied collateral metrics in Luxembourg are

Guy Knepper, head of securities lending CACEIS

"We are definitely headed towards more diversification now that the funds which are typically beneficial owners are more cautious about investing in government bonds. They are diversifying their portfolio and entering into equities and corporate debt and therefore the move in collateral management follows on from that. As they diversify their investment portfolio, they are also progressively diversifying their collateral portfolio. We already see unsecured cash lending in repo markets disappearing and at some point there will not be enough high quality sovereign debt to go around, so I think we will see this continue into securities lending," Wilkin says.

This is also evidenced by the increasing demand from lenders for independent collateral management services. The days when lenders gave mandates to a single custodian or agent to be a one-stop shop are coming to end, he adds.

"In the past, someone gave a mandate to a custodian and they were the global custodian, the settlement agent, did the lending, collateralisation, they did it all and lenders just wanted the cheque at the end of the month, that is over, now lenders are cautious and segregate functions and responsibilities to protect themselves," Wilkin says.

One of the custodians that does operate a desk within Luxembourg is CACEIS, the asset servicing banking group of Crédit Agricole. The bank provides depositary and custodial services, fund administration, middle office services, fund distribution support and issuer services to its institutional and corporate clients.

transactions which put technical burdens on the back office, which is still the case in neighbouring Germany. In addition, Germany also maintained a 10 per cent maximum exposure per counterparty, whereas the Luxembourg regulator mandates that exposure should be kept at a reasonable level, which Knepper interprets as having the ability to reimburse all shareholders when necessary.

One notable peculiarity of Luxembourg's regulation involves the level of collateralisation required to protect securities lending transactions. The minimum is set at 90 per cent of the global valuation of the securities lent (interests, dividends and other eventual rights included) during the lifetime of the lending agreement. Knepper points out that CACEIS collateralises at 105 per cent, and other market observers note that they are unaware of any agents that take advantage of this regulation, particularly in an environment where lenders are carefully scrutinising counterparty risk.

Now lenders are cautious and segregate functions and responsibilities to protect themselves

Jean-Robert Wilkin, head of product management for Global Securities Financing Clearstream

As a custodian lender, it is a multi-market player focusing on clients in Luxembourg, France and Germany across asset classes such as government or corporate bonds, convertible bonds, equities and exchange-traded funds (ETFs).

Its Luxembourg-based desk operates for any clients throughout the network, a large portion of which are UCITS funds, and its operational set-up concentrates flow as much as possible through the central location.

Leading into the GSF Summit, Guy Knepper, head of securities lending at CACEIS, points to collateral management as an area where he would like to see more information – particularly on the diversification end.

"There is not enough transparency around what the applied collateral metrics in Luxembourg are…the relevant statistics are missing. Since the legislation leaves room for a broad scope of collateral, like shares, equities, corporate bonds for example, it would be very interesting to see how many investment funds have opted for larger metrics moving away from government bonds or cash. There are a lot of grey areas in this respect," Knepper says.

Luxembourg desk

Luxembourg's relevant regulation, Circular 08-356, prescribes the conditions by which funds may enter into securities lending transactions. When it was overhauled in 2008, the regulator ended a 30-day limitation for securities lending

The Luxembourg securities lending market is driven by international scope while the domestic market is very small, with just three major companies with significant international exposure – steel giant Arcelor Mittal and its spin-off Aperam and satellite operator SES. But the total market valuation of these companies is just some €35 billion.

But it is not so much in equities, rather the physically-backed ETF business that Knepper is seeing the most growth and he notes that ETFs are becoming more widely accepted in the securities lending market, particularly for directional trades.

As of August 2011, French-domiciled investment funds cannot lend ETFs as part of an overall ban on major financial stocks. This is not likely to be repeated in Luxembourg, however, Knepper says.

"As with all investment funds under new rulings such as UCITS IV where you have short prospectuses, the most sensible way to approach the ETF issue, from my perspective, is to also have the same rules for them, so this would seem to be the logical next step for ETFs," added Knepper.

He does, however, express the belief that there may not be enough transparency around the products, but with markets shaken investors are likely going to be taking a much closer look at the risks of what they are buying than they previously have. **SLT**

Managing risk

Frank Reiss, head of global financing product management at Euroclear, talks to SLT about shifts in collateral management behaviour in the aftermath of the global financial crisis

BEN WILKIE REPORTS

SLT: In terms of collateral management, what have been the biggest changes post-crisis?

Frank Reiss: Financial firms are still very conscious of the risks rooted in recent periods of economic turbulence. Prior to the crisis, the bulk of Europe's triparty collateral management business supported repo and securities lending transactions, using securities as collateral. Today, we are seeing more demand to cover other types of exposures, including OTC derivatives, CCP margins and for central bank liquidity.

There has also been a shift in the use of securities as collateral. There is now a tendency to only accept high quality types of assets as eligible collateral in commercial transactions. Today, top rated securities are in scarce supply and hence we see our clients looking to be more innovative in how they optimise their assets as collateral. This includes securities and cash, as well as new asset classes, like syndicated loans.

SLT: The ongoing financial crisis has seen regulators propose new regulation and expand existing scope. Is this a help or a hindrance?

Reiss: There is a whole raft of pending legislation. It very much depends where you stand in terms of additional regulation being a help or a hindrance. Any new regulation which improves our capital markets is to be welcomed. But new regulation must not come at the cost of restricting liquidity or hindering competition.

One concrete result of the crisis and the pending new rules is an increase in regulatory oversight. Gone are the old days of 'light-touch' supervision and unsecured lending. Regulations such as Dodd-Frank and EMIR are pushing OTC derivative transactions to be centrally cleared in secure environments such as central counterparty (CCP) clearing houses. In order to cover the increasing collateral requirements for OTC derivatives or CCP margining, clients aim to capitalise on the Euroclear triparty environment to post cash as collateral, in addition to securities.

SLT: What is Euroclear doing to assist market practitioners with collateral administration and management?

Reiss: Earlier this year, Euroclear launched a service to mobilise cash as collateral in a risk-controlled way within the triparty environment. When cash is received as collateral, clients need cash re-investment possibilities. So, we have developed options for clients to reinvest the cash received as collateral in triparty.

One of them is to reinvest cash into a money market fund via FundSettle - Euroclear Bank's dedicated platform for cross-border fund processing. We have teamed up with BlackRock, one of the world's leading asset managers, to make their money market funds available for cash collateral re-investment.

Other large asset management houses are also signing up to work with us on this new service. Euroclear Bank is offering cash re-investment services in these funds for clients receiving cash collateral for virtually any triparty transaction. It is particularly useful when clients receive cash as collateral while collateral acceptance criteria are redefined due to rating downgrades.

Another example is Euroclear Bank's role in collateral transformations. We are increasingly assisting clients that do not have readily available asset classes of collateral to meet the eligibility requirements agreed with the collateral taker. Through our triparty services, we transform available collateral such as cash and/or equities into eligible collateral, such as fixed income securities. **SLT**

Frank Reiss
Head of global financing product management
Euroclear

Custom lines

Following Tradeweb's launch of a European repo market platform last March, director of the firm's money markets business, Nigel de Jong, speaks to SLT about how the new platform has been received by the market

SLT: Tell me a little about Tradeweb?

Nigel de Jong: Tradeweb's core focus in Europe is the customer-to-dealer market, as opposed to the inter-dealer market. We provide more than 20 electronic trading platforms for customers worldwide, trading in government bonds, credit, derivatives and money markets. Tradeweb has established a strong presence in many of these markets over several years and the new repo market is complementary to these markets. It's also a key fit with a number of our existing customers.

SLT: With Tradeweb's new European repo market focusing on the bond side, is now a good time to be launching it - do your customers have time to implement it?

de Jong: Buy-side institutions have driven the response from Tradeweb to launch a new electronic market for repo. We need to see the customer demand before developing any new markets. In fact, we work closely with both buy-side and sell-side institutions in order to build and implement any new trading platforms we develop.

SLT: How did the development start?

de Jong: The demand for the European repo platform goes back to 2007-08. What we were seeing at the beginning of the credit crunch was a move from unsecured to secured lending. We were talking to a number of institutional customers who may have been lending cash before on an unsecured basis, and who were now looking to translate that business into the secured area - such as short term bills, which we already offered, or repo, which we have now brought in. It was a natural progression for our existing money market business, where we have customer deposits, CDs and ECP. There's a lot of synergy with the types of customers who are doing that type of business who are moving their business more towards repo.

So is it a good time to be introducing a new venue for trading repo? Well, as ever, customers are focused on reducing credit risk. Anything that helps improve the efficiency of the repo market must therefore be of benefit to customers.

SLT: How did the development process work?

de Jong: We spent a long time with our customers and with our dealers asking for and understanding their requirements. Obviously the repo market in Europe is quite fragmented in terms of the types of instruments and the ways people transact their business on a regional basis. Funds in London may have different styles or ways of operating in the market to those based in say Paris or Frankfurt. So we used our existing contacts, people who have expressed interest in having an electronic repo offering, to check the way that they trade and operate so we could formulate our responses to building the platform. And that's why we've come up with quite a wide offering when it comes to the product, rather than a narrow one that just looks at a segment of the repo market. We wanted to offer a relevant product to a wide customer base.

SLT: Was there any resistance from firms who value the personal relationships over electronic trading?

de Jong: I think there is focus on creating efficiencies. There will always be personal relationships and I think this new trading venue offers a key advantage in that respect. As a time-saving tool, traders and dealers are enabled to develop even closer relationships - if you spend half an hour looking at your repo trades, that's half an hour that could have been spent talking to your clients about what else they want to do. So I think it can be seen as quite the reverse, it gives you more time to develop relationships.

SLT: So it can be a hybrid, with the benefits of electronic trading and relationship building?

de Jong: We haven't tried to change the market, we've looked at the way people trade and looked at their workflows. And we've tried to mirror those workflows and protocols. We don't take away anything the market does today, we've just translated it from a phone or a message into an electronic platform that then gives the benefits of STP and faster execution times. It puts all the processes in one place and at one time.

SLT: How far down the trade process does the platform operate?

de Jong: We are replacing the execution part of the business. We are not directly sending instructions to a settlement centre. But what can happen is that the message that is translated from Tradeweb to those companies' back office systems or trading platforms will in turn be passed on to the settlement centre.

SLT: Is it your existing clients that will be using this platform, or are you expecting new clients to come on board specifically for it?

de Jong: During the initial stages when we were looking at building the platform it was key to understand the dealer-to-customer relationships, their workflows and so on, in order to build it. But our experience has shown that we now have a mix of customers, some who were existing Tradeweb clients and some who are new to Tradeweb.

SLT: Are there issues around regulation that you feel this new platform can solve, or is it simply a case of institutions wanting to improve their internal processes?

de Jong: Repo touches many different markets and there is potentially a broad field of regulatory issues. We attend meetings such as those held by ICMA and we are always cognisant of the debates going on from a regulatory point of view. Does Tradeweb European Repo address any regulatory concerns? I don't think it needs to at the moment, but it's a fluid topic and one we will continue to stay informed about for all related markets.

SLT: What does the process of implementation involve?

de Jong: From an implementation point of view, our customers across the globe already have our software on their desktops, so there's no additional requirement to implement new software - access to the platform can very simply be enabled. For new customers, installation is a relatively straightforward process as Tradeweb is a thin client application that connects over the internet. Of course, what they do with the post-trade information is the next step and this applies both on the customer and the dealer side - once the trade is done, what is the flow of the trade and how do they use the information they get from our feeds. Many clients are used to receiving post-trade messages in a certain way from Tradeweb and repo becomes an extension of those messages we send.

SLT: But it's people on the repo desks who will now be using this system rather than your existing users?

de Jong: No, there is a mixture. Some of our customers solely deal with repo, but more often they will deal with a variety of products. It may be a customer's short end money market desk dealing in repo but also in products such as short-term bills, FRNs, tail-end bonds, etc. In many cases, repo will be an addition to the markets they access on the platform.

SLT: Has the dealer response been similar to the client response? Are they taking the platform because their clients are asking them to, or do they see the benefits independently?

de Jong: We see both. We see both the requests from clients and we also see a response from dealers as an efficiency tool to bring this business closer in alignment with other markets where they already have electronic systems with the customer side.

SLT: Is there a particular geographical spread of clients?

de Jong: It's difficult to pinpoint. We are fairly pan-European on both the customer and dealer side. We don't have too much response from the emerging markets yet, it's a much smaller space, and this is a relatively young platform so we need to get gravity in the larger markets first.

SLT: Has the platform already reached the scale to become useful to all European markets?

de Jong: I think to some degree, yes. It's already of great use to some people and it's becoming more relevant as we add dealers. We need to remember that customers have relationships with certain dealers and when those dealers commit and subsequently go live then it becomes more relevant. There is a continuous process - implementing dealers, and encouraging the customer growth. SLT

Nigel de Jong
Director, money markets
Tradeweb

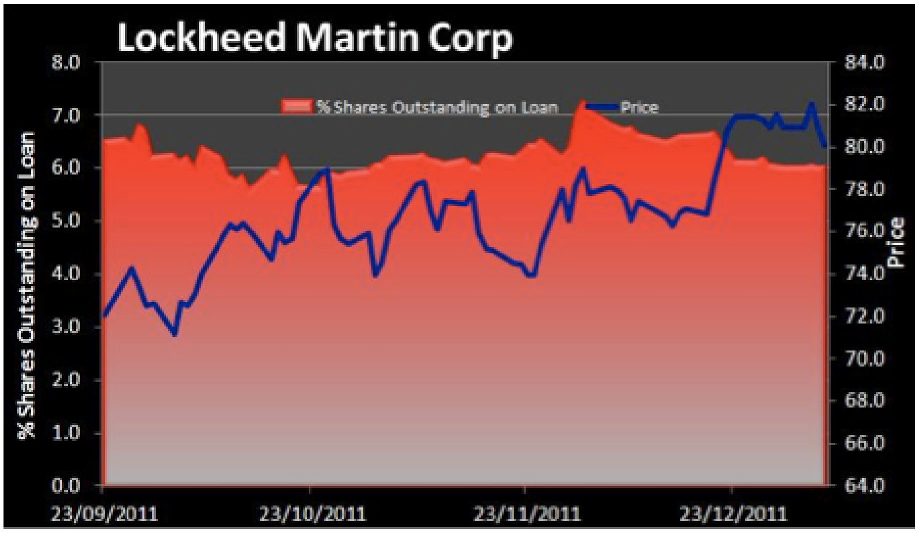
The repo market in Europe is quite fragmented in terms of the types of instruments and the ways people transact their business on a regional basis

Crystal Ball

Is 2012 the year for recovery, asks Data Explorers' Will Duff Gordon

Investors looking to bid farewell to recent soggy returns can look for sizable gains by buying companies in recovery mode. The greatest Long Short strategy of 2012 would be to predict those companies whose intellectual property and assets are too strong to leave them on the ropes any longer, whilst also correctly guessing which high flying titans are due to slip on the proverbial banana skin. Securities lending flows highlight where the smart money is going.

Companies covered include: Yahoo! (NASDAQ: YHOO), RIM (TSE:RIM), Nokia (BIT:NOK1V) ,BP (LSE:BP.), Keycorp (NYSE:KEY) and Lockheed Martin (NYSE:LMT)



Large European mutual fund, M&G, has a famous $11 billion fund that tries to own companies on the comeback trail. Tom Dobell's "Recovery Fund" lists BP as its biggest bet on a rebound. Investors don't seem to have a strong view. Lending institutions own an average amount of BP's shares (20 per cent) and short selling is perennially low.

A more decisive view for Yahoo! is expressed when reading the tea leaves garnered from securities lending flows. Funds who lend have been buying shares and their holdings now stand close to a two-year high, while short selling is at a very low ebb of under one per cent of all shares. The new CEO has much to do but some believe this could be their year if the group were to sell its stake in Alibaba or Yahoo! Japan to boost cash reserves and make the resultant business easier to buy.

Mobile phone zone

Blackberry maker, Research In Motion, has very few friends in the stock markets. Aside from some late December short covering (or profit taking?) short sellers are betting on the next move being downwards, with shares on loan close to a two-year high in both the Canadian and US listings at six per cent and 2.5 per cent respectively. Funds who lend have been reducing their holdings also. RIM is a brave recovery play indeed but has further to snap back should it steady the ship this year or find a suitor.

Nokia has been flat lining at around €4 for the last six months so the big question is where next for the share price. Securities lending flows indicate you need to look elsewhere for positive energy, since short sellers almost doubled their negative bets in Q4 while funds who own and lend Nokia hugely reduced their holdings in the same period.

Banking on banks

Should there and could there be a bank in this list of recovery plays? M&G's fund includes HSBC in its top holdings but one could argue that this isn't a true phoenix from the flames prediction given how the banking giant has held up in recent times. For this reason we also exclude Standard Chartered and JP Morgan. As a sector, sentiment is more positive than negative when looking at the thirty day change. 19 banks are showing rising institutional ownership concurrent with falling short selling toward EMEA banks with seven showing the opposite. Interestingly, the top three showing the most positive sentiment are Barclays, Lloyds Banking Group and Bank of Ireland.

The situation is skewed to the positive even more tellingly for US banks, with Keycorp topping the list. This is only looking at the monthly change but, even so, could 2012 be the time that bank shares stabilise and creep northwards?

Distraction for extraction players

So who will fall from grace in this game of corporate snakes and ladders? This is the million dollar question now that the concept of evergreen 'blue chips' is not what it used to be. With Anglo American at loggerheads with the Chilean government over a co-owned copper mine and both Chevron and Exxon Mobil in the dock regarding the impact on the environments in which they operate, one trend we can remark upon is an appetite to take on these massive companies where disputes or damage occurs.

Short selling is absent in these firms but it is the institutional investors whose weight of money has the power to mark down their share prices if they run for the hills should scandal turn into massive liability. The last six months has seen a reduction if the amount of shares in the big UK listed miners held by the large asset managers and one wonders if this is temporary or the shape of things to come.

Defence industry on the defensive

One thing that seems apparent is that the US will spend less on aerospace and defense this decade compared to the last one, where the nation's role as the global police force cost trillions of dollars. Obama has just announced as much. Boeing sees positive investor sentiment but Lockheed Martin does not. Short selling has risen to a two year high of six per cent and funds are reducing their holdings. It remains to be seen if emerging markets can make up the shortfall in orders. Those firms without a global reach could be in for a challenging few years. **SLT**

Will Duff Gordon
Research director
Data Explorers

Industry appointments

LCH.Clearnet has appointed Lisa Rosen as group head of compliance and public affairs overseeing the clearing house's regulatory and lobbying activities. She joins from Barclays Capital, where she was managing director and global head of regulatory affairs.

"I am delighted to be joining LCH.Clearnet at this exciting time, when clearing is at the forefront of regulatory and legislative developments. Recent events have demonstrated the critical role played by LCH.Clearnet in mitigating systemic risk across a broad range of markets," said Rosen.

Before her role at BarCap, she was with Merrill Lynch for ten years, where, latterly, she was first vice president, head of litigation and contentious regulatory matters for EMEA.

Christophe Hémon, COO at LCH.Clearnet and to whom Rosen will report, said, "The regulatory and legislative landscape is evolving fast. We are very pleased to have Lisa join us at this important time."

Nasdaq OMX has appointed Arminta Saladziene as head of the Group's Baltic market. The market comprises the three regional exchanges, the CSDs of Estonia and Latvia as well as a network of local and international members.

"Nasdaq OMX will continue the consolidation in the Baltic Market amidst global economic uncertainty [and] offers Baltic and CEE companies a trustworthy market place to raise capital for the ideas of tomorrow," she said.

Saladziene will hold the current position as president and chair of the management board of Nasdaq OMX Vilnius. She is also a member of the Baltic management team and director on the board of Lithuania's CSD.

BNP Paribas Securities Services (BNP Paribas) has appointed Nobuya Shida as head of securities services in Japan.

Shida, a business veteran with 26 years' experience in the Japanese financial industry, has been appointed to grow BNP Paribas' securities services business in Japan. The business will provide services to institutional investors and financial intermediaries. These include global custody and clearing, specific financial operations outsourcing, and other global products subject to the foreign bank agency business license to be granted by the Financial Services Agency of Japan.

These services are in strong demand with increasing offshore investment allocations by Japanese asset managers and asset owners, as well as securities firms and trust banks who continue to search for diversification and investment returns. BNP Paribas has already won several mandates from Japanese clients this year, including a major global custody and fund services deal from a top asset manager for its operations across the region, a custody mandate from a trust bank for its assets in Europe, and a clearing mandate from a securities firm for its activities in Hong Kong.

Commenting on the development, Lawrence Au, head of Asia Pacific at BNP Paribas Securities Services said: "This is another important strategic step in implementing our securities services business plan for the region – adding to our presence in Hong Kong, Singapore, China, Australia, New Zealand and India.

"We are delighted that Nobuya has joined our team. His breadth of experience and extensive business network will be significant assets in our efforts towards developing our business in the sophisticated Japanese market," continued Au, who is also a member of the custodian bank's executive committee.

"BNP Paribas has a long history of operating in Japan and is a leader among the foreign banking groups in the market with strong and established relationships with many key institutions," added Yannick Jung, general manager of BNP Paribas Tokyo Branch. "We are confident that our securities services solutions, combined with the strengths of other businesses in the Group, will provide Japanese buy-side and sell-side clients with the right long-term partnership to overcome market complexities in support of their investment offshore."

Nobuya joins BNP Paribas from Brown Brothers Harriman Japan, where he was most recently senior vice-president and head of relationship management. Prior to that, he was with JP Morgan Chase where he held various senior positions, including head of Asia Pacific Corporate Banking and Osaka branch manager.

Apex Fund Services (UK) has received authorisation by the UK's Financial Services Authority as a Fund Operator.

As a Fund Operator, Apex's UK office is now one of a small number of administrators in the country that is authorised to provide independent administration services to regulated collective investment schemes domiciled in the UK. Importantly all UK based investment managers will be serviced locally from London.

Leading the growth of the London office is Colin Targett who joins the company from Standard Bank in Jersey where he was head of valuations. Targett is a highly experienced fund administrator having formerly been Vice President at BISYS (now Citi). After qualifying as a chartered accountant he joined KPMG Bermuda in 1998 to specialise in the audit and accounting of alternative investments funds.

Commenting on the authorisation, Peter Hughes, group managing director said: "With offices in most of the world's financial centres the timing is now right for Apex to launch in the UK. The economic uncertainty is making high quality levels of service and innovative products more and more valuable to investment managers. Receiving FSA authorization demonstrates this is precisely what Apex offers its clients.

"Our strategy of global reach, service locally continues to drive the successful growth of the Company and we look forward to Colin bringing his own extensive experience to Apex."

Commentating on his appointment, Colin Targett, managing director of Apex Fund Services (UK) Ltd added: "Since its launch eight years ago I have monitored Apex's rapid growth and personal approach to client servicing. Opportunities to launch an office in London for a fast growing global company don't come round often. **SLT**

SLT SECURITIESLENDINGTIMES

Editor: Ben Wilkie
editor@securitieslendingtimes.com
Tel: +44 (0)20 3006 2710

Journalist: Anna Reitman
annareitman@securitieslendingtimes.com
Tel: +44 (0) 20 3006 2888

Marketing director: Steven Lafferty
design@securitieslendingtimes.com
Tel: +44 (0)784 3811240

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
Tel: +44 (0)20 8249 2615
Office fax: +44 (0)20 8711 5985

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