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Industry adapting to 'new reality'

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IMN's 18th annual Beneficial Owners' International Securities Lending Conference in Arizona brought together industry leaders to address the latest issues impacting markets. SunGard's Tim D'Arcy decided on Pink Floyd to set the opening mood: Comfortably Numb.

He was referring to the new reality, or as PIMCO has dubbed it, the 'new normal', that the securities lending industry is adapting to. Looking back over 2011, across the globe trends indicate higher levels of returns coming from specials and GC trade is expected to remain muted as beneficial owners struggle to make the numbers work. There is little anticipated change to this story throughout 2012.

A wide diversity of programme and administrative objectives were represented on several panels, with views on emerging markets and smaller funds as well as market insights from executive decision makers. Representing a state agency with an investment portfolio of $27 billion, one CEO described the conditions under which the securities lending programme was defunded by 99.9 per cent. The state agency's reason was the potential of too much risk as a result of portfolios holding equities and illiquid fixed income while potential risks were also identified over a concentration of European paper.

As a result, "tertiary risk" reached a high tolerance threshold. The securities lending programme of some $3.5 billion was taken down to zero, with just some assets under water with liquidity issues left to sort out before the agency implements a full exit strategy.

Still, others reported reasonable returns, particularly those funds with specials only programmes, and cited improved spreads and balances in 2011. In general, cautious optimism remains the order of the day though many market participants said they saw few catalysts for growth. On the borrower side, representatives of the hedge fund community did point to the European Central Bank's Long Term Refinancing Operation (LTRO) as a positive development and possible 'game changer' for liquidity issues in Europe.

NEWSINBRIEF

Shorter interest means longer slump - RBS

According to a recent study from RBS, increased short selling activity leads to medium term stock underperformance. The new study confirms findings from 2010 showing that when there was a 25 basis point increase in short interest as a proportion of issued capital for over one week, the stock underperformed its sector by 1.7 per cent in the following three months, on average.

Moreover, when the change in short interest is higher, 50 bps, 100 bps and 150 bps, in all of the tests, stocks underperform the market in the following three months. This suggests short sellers' trading strategies have an element of momentum to them, notes RBS. In fact, when weekly short selling exceeded 150 bps, stocks on average underperform the market by 4.6 per cent.

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eSecLending launches proxy service

eSecLending has launched a new service which will help institutional investors evaluate the revenue considerations of recalling shares.

readmore p2

INSIDE SECURITIES**LENDING**TIMES

Shorter interest means longer slump - RBS

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Using short interest data has helped the team generate significant alpha. Since its inception in December 2010, RBS Australia's 130/30 model portfolio has an annualised six per cent outperformance versus the benchmark Australian capital market index.

This year, the team also included calculating short interest as a proportion of a stock's free float as well as a days-to-cover ratio.

"A major consideration of short sellers must be liquidity/turnover and the ability to cover their shorts whilst avoiding a short squeeze. Ceteris paribus, when liquidity is lower, a higher conviction idea will be required to generate a trade due the potential of a short squeeze being higher. This is a particularly important consideration in periods of low volumes, as we are currently experiencing," RBS analysts said.

Findings show that predictive power is boosted with these variables as well as when data is scrubbed for errors. In the Australian market, RBS estimates short seller profits of some AUD 72 billion (€58.5 bn).

Data Explorers launches app

Data Explorers has launched the first iPhone app for the global securities lending market. That means over three million transactions covering some $12 trillion of securities in lending programmes of over 20,000 institutional funds have been squeezed in an app.

Clients can monitor live changes in short selling activity and holdings of institutional investors at a stock, sector and market level as well as access the securities lending data provider's newswire and video.

"The long reign of BlackBerry as the securities lending professional's favorite gadget is under threat from the new generation of iPhones that have already been adopted by leading financial institutions", said Jonathan Morris, COO at Data Explorers.

The Data Explorers iPhone App is a fully featured market data and news application with market and sector overviews, single security tear sheets and customisable watch list. Data is updated throughout the day live from the Data Explorers API, DX Open.

eSecLending launches proxy service

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When participating in securities lending, institutional investors often find it challenging to effectively manage the dual objectives of revenue generation and corporate governance responsibility. So, in partnership with Institutional Shareholder Services (ISS), eSecLending designed the new service, ProxyValue, to apply securities lending performance information to proxy voting management.

Matthew Newman, VP for ISS, said, "Our clients are continuously seeking ways to efficiently and effectively execute on their proxy voting responsibilities while also maximising incremental revenue opportunities. ISS is pleased to partner with eSecLending in its goal to help institutions evaluate the economic and fiduciary impact of recalling shares."

ESMA drafts securities lending rules for ETFs

ESMA has introduced requirements for ETF securities lending and collateral management while also broadening the scope to include all UCITS. In general, posted collateral should follow existing UCITS diversification rules and should have a documented and appropriate haircut policy for each category of assets, the European markets regulator said.

UCITS diversification rules essentially prescribe restrictions on the proportion of any single component of an index replicating product. ESMA's recommendations are being viewed as letting securities lending off lightly as fears had been growing that the practice might have had heavier regulatory requirements.

Steven Maijoor, ESMA Chair, said, "In outlining the draft future rules for investment funds today, ESMA is proposing to reinforce the legal framework applicable to ETFs and other types of UCITS. The aim of these guidelines is to enhance investor protection and limit the risk of certain practices by strengthening, in particular, the standards applicable to collateral received in the context of activities such as securities lending.

"Moreover, the proposed guidelines improve the quality of the information provided to investors to allow them to make informed investment decisions. Furthermore, the draft guidelines help address concerns arising from the increase in the number of complex products sold to retail investors and will contribute to the convergence of the regulatory framework for these products."

Comments on the guidelines will be accepted to 30 March and final guidelines are expected to be ready for adoption by mid-2012.

ESMA's final guidelines will be published in the same year that the FSB is looking into regulation of activities related to securities lending and repos, which are expected to include measures on margins and haircuts. FSB's policy recommendations are expected at the end of 2012.

SEC charges Wolfson Brothers with short selling violations

The SEC has announced it is charging two brothers living in Chicago and New York with naked short selling violations.

According to the SEC's order instituting administrative proceedings against Jeffrey and Robert Wolfson, the brothers generated more than $17 million in ill-gotten gains from naked short selling transactions.

The SEC added that in a recorded telephone conversation, Jeffrey Wolfson stated, "What I sell them is not guaranteed, it never gets delivered, it's funny paper."

The SEC's Division of Enforcement alleges the violations occurred while Jeffrey Wolfson was working as a broker-dealer himself and later as the principal trader at a Chicago-based broker-dealer that is no longer in business. He also taught his brother and others how to do it. Robert Wolfson conducted illegal naked short sales while trading through an account at New York-based broker-dealer Golden Anchor Trading, which also has been charged in the SEC's enforcement action. The firm has changed its name to Barabino Trading.

"By engaging in naked short selling, the Wolfsons had a major advantage over competitors who complied with the law and incurred the costs associated with actually borrowing the securities," said George Canellos, director of the SEC's New York Regional Office. "The SEC is committed to recovering substantial ill-gotten proceeds made by traders who seek to circumvent important short selling regulations."

Greece extends short selling ban

Greece is extending a short selling ban until 25 July, according to media reports. The ban came into effect in August and was set to expire 27 January.

"The Capital Market Commission is closely monitoring market developments and relevant decisions in the European Union," the regulator said in a statement according to Dow Jones.

The news wire added that the commission said it may review its stance before the ban's new expiration date in cooperation with securities regulators in France, Italy, Spain, Ireland and Belgium.

NYSE Group and NASDAQ report January short interest

Short interest increased for NYSE and NASDAQ but NYSE Amex saw a drop for the two-week period to 13 January.

NYSE's short interest rose to 13.4 billion shares from 12.7 billion shares, or up 5.4 per cent. The short interest on 13 January was equal to 3.5 percent of the total shares outstanding.

NASDAQ too saw a lift, of 3.9 per cent, to 7.1 billion shares across 2,747 securities compared with 6.8 billion across 2,752 securities in the previous reporting period. The short ratio, or the number of days' volume represented by outstanding share positions, was 5.4 days of average volume, compared with 3.7 days for the prior period.

Bucking the trend, NYSE Amex saw a slight drop in short interest to 405 million from 408 million. A short position of 5,000 or more shares existed in 322 issues. Some short position was shown in 504 issues.

Solvency II an opportunity for hedge funds?

Solvency II could be a unique opportunity for hedge fund strategies to find their way into insurers' core portfolios according to recent research from EDHEC Risk Institute.

Upon implementation of the regulation, insurance firms will have to maintain underlying capital equivalent to 49 per cent of their total hedge fund investments, which analysts cited by HFMWeek said could lead to redemptions. However, hedge funds can avoid these capital charges if the insurance firm which invests builds an internal model to demonstrate that the risks present do not necessitate a 49 per cent capital holding.

According to the EDHEC Risk Institute, that is a distinct possibility. Applying a pragmatic and robust internal model approach to a series of investable hedge fund indices over an observation period covering the recent crisis, the researchers found that a stress test of no more than 25 per cent is appropriate for a well-diversified hedge fund allocation.

Mathieu Vaissié, senior portfolio manager at Lyxor Asset Management and author of the report, explained that he uses the term "hedge fund strategies" to make clear that understanding the hedge fund industry requires drilling down to that level as opposed to taking a composite view. And which strategy might be suitable for any given insurance company can vary. "The strategies insurance companies are interested in depends on their risk/return preferences and as a result their current asset mix, their funding ratio, and the way they intend to use hedge fund strategies (ie, risk reducers, return enhancers, etc). They definitely are keen on investing in short risk strategies, although short selling might not be their preferred route," said Vaissié.

In the report, he argues that there is no reason why hedge fund strategies should be placed in the "other equities" category, next to "emerging equities", "private equity" or "commodities", and suffer such poor treatment as in the standard approach. At the same time, insurance companies face significant challenges.

"There is indeed little chance in the current environment that insurance companies will favour hedge fund strategies over traditional performance-seeking assets knowing that the capital charge is currently materially higher (49 per cent versus 39 per cent for equities). In its current form, the Solvency II framework is thus preventing insurance companies from leveraging alternative diversification and implicitly directing them towards fixed income instruments, which may not be as safe an investment as one would have assumed. Paradoxically, the directive could put insurers' long-term capacity to control their funding ratios at risk."

ESMA launches short selling consultation

The European Securities and Markets Authority (ESMA) has released a consultation draft on short selling and CDS. Some of the aims of the 55+ page document are to clarify the meaning of "reasonable expectation" for locating shares or sovereign bonds and to define which third parties will be eligible to provide confirmations.

In general, the test for reasonable expectation for the borrowing of shares or sovereign debt requires that a third party confirms that, at least, the share has been located and that the third party has taken measures to ensure settlement can be effected when it is due. The language is similar for uncovered short sales.

For intraday short selling, the reasonable expectation test is met by obtaining a confirmation that the shares are easy to borrow or purchase from the third party from which the location con-

firmation was sought. However, ESMA notes that this means investors are required to provide a statement as well as continuously monitor the uncovered short position. In addition, the investor has to provide instructions to the third party to procure remaining shares not covered by same day purchases.

Eligible third parties include authorised investment firms, trading venues, CCPs, securities settlement systems, central banks, a national debt management entity or an active participant which qualifies under EU law and can provide data on its ability to deliver for settlement.

ESMA added that confirmation should come from parties that will have some kind of involvement in the process for the location, borrowing or purchasing of the shares or sovereign debt instruments and not from “disinterested third parties who do not put any skin in the game”. As such, providers of data on securities lending markets, actors and activity are not included as eligible third parties.

In November 2011, the Council and the Parliament voted on a regulation on short selling and certain aspects of credit default swaps. The regulation is expected to come into effect starting November this year and ESMA is to submit its technical standards by the end of March. The consultation period ends on 13 February.

GlobeOp sees drop in hedge fund redemptions

Hedge fund redemption requests for January measured 1.9 per cent, a drop on last month’s 4.6 per cent, according to GlobeOp’s forward redemption index.

This could reflect typical seasonal reallocation of investments as investors take money out in January and redeploy it in February and March, the company said in a statement.

“January 2012 is the lowest month for hedge fund investor redemption notifications since Index records began in 2008,” said Hans Hufschmid, CEO, GlobeOp Financial Services. “While January notifications are typically lower than December, this year is also substantially lower than the January 2011 requests of 2.8 per cent.” Forward redemptions as a percentage of GlobeOp AUA have trended significantly lower since reaching a high of 19.3 per cent in November 2008.

In other news, TPG Capital has agreed to acquire the hedge fund adminstrator for £508 million, pending regulatory approvals.

Sponsors look to alternatives

US plan sponsors are starting to look closer at alternative repo products as a solution to the challenges they face in securities lending and collateral management programmes, according to the latest Finadium survey.

One of the key findings of the survey is that repo for equities and illiquid assets as well as term repo are slowly gaining in popularity as a way to incrementally increase collateral returns, though they are viewed as riskier.

“In the past few years, there has been a well-known pendulum swing away from using collateral to reach for increased returns towards much more conservative collateral investment choices which limit the level of return…what we are seeing now is more plan sponsors saying they will look at equity or illiquid ABS repos,” said Josh Galper, managing principal at Finadium and author of the report.

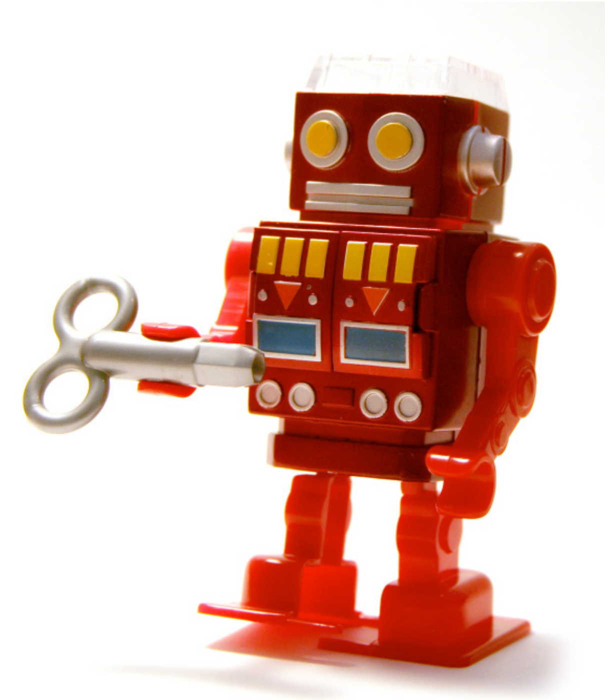

NORTH
ATLANTIC
COLOMBIA
PERU
BOLIVIA

Banks need to fund paper at a time when high quality liquid collateral is getting scarcer. Meanwhile, plan sponsors are reporting that they are feeling they might be outbid or outmanouevred for traditional products if they are not willing to consider alternatives.

"This is a slow but real change, recognising that treasury and agency repo is either in insufficient supply or does not provide sufficient returns...Under Basel III, treasuries and agencies are high quality liquid assets and when liquidity coverage ratios start to kick in, banks need to be as agile as possible about funding their non-high quality liquid asset positions… they may choose to give repos to the fund that takes both treasuries and illiquid ABS' or equity repo," Galper explained.

Though equity repos are perceived as riskier by respondents to the survey, Galper pointed out that particularly for overnight equity repo, risks are low with some agent lenders now offering indemnification.

Now in its fifth year, the Finadium survey of US plan sponsors looks at the attitudes and opinions of these institutional investors across securities lending, collateral management and custody.



BlackRock securities lending revenue up in Q4 2011

BlackRock operating income in the fourth quarter of 2011 decreased 14 per cent to $808 million year-on-year on the back of a drop in investment fees, offset by a lift in securities lending revenues.

The firm cited a reduction in investment advisory and administration fees as one of the primary reasons for an 11 per cent drop y-o-y in overall revenues, which ended 2011 at $2.2 billion.

The decline in revenue reflected market driven reduction in equity assets under management (AUM), offset by $15 million higher securities lending fees due to an increase in average balances of international securities on loan, the company said.

Fees and securities lending returns were at $1.9 billion in the fourth quarter, which dropped $88 million, or five per cent, from $2.0 billion in the same period last year. The decrease in fees reflected lower average AUM.

AUM dropped one per cent to $3.5 billion from $3.6 billion year-on-year, however, there was a gain of five per cent quarter-on-quarter from $3.3 billion.

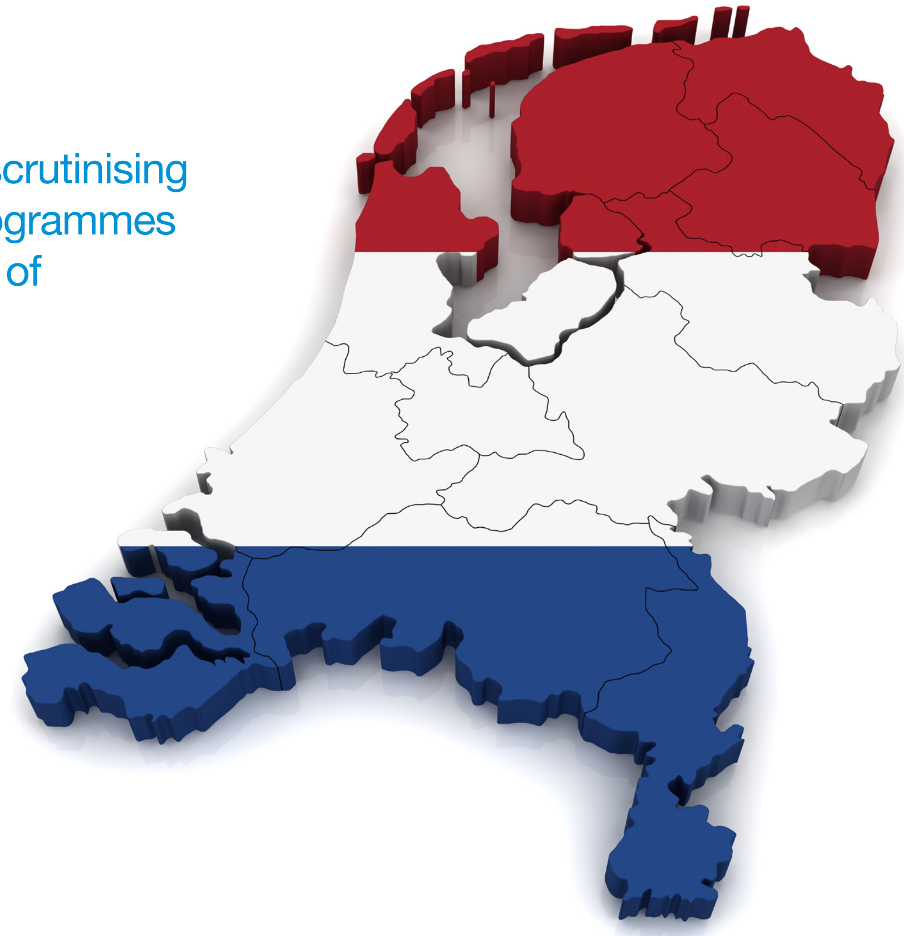
Data Explorers launches robot journalist

Data Explorers has partnered with Narrative Science to create the world's first securities lending newswire using an artificial intelligence system. Narrative Science helps companies create editorial content at a speed and scale that was not previously feasible. The company's artificial intelligence system takes raw data and transforms it into narrative content including stories, insightful business reports, tweets and more.

Data Explorers is currently in the final stages testing the system internally and expects to go live on the site in the next couple of weeks. The authoring technology will be able to write 20 articles a day about short selling and institutional investor holdings identified by some three million intraday transactions in its database.

Jonathan Morris, COO of Data Explorers, said, "Narrative Science enables a relatively small financial data organisation to create its own bespoke newswire". The newswire will also be made available on third party market data providers, Bloomberg, Capital IQ and FactSet.

Netherlands



Dutch pension funds are scrutinising their securities lending programmes more than ever as a result of economic and regulatory pressures

ANNA REITMAN REPORTS

Securities lending providers are reporting big changes in the Dutch securities lending market place as a result of the post-Lehman pull back and sovereign debt crisis fallout.

The domestic economy is punctuated by weakening demand as financial turmoil makes investors and consumers more cautious, according to a recent review by the Organisation of Economic Cooperation and Development (OECD). The big concern is that these factors are damaging the solvency of pension funds - possibly the most significant lenders in the Dutch securities lending market.

At the same time, demand to borrow Dutch equities declined over 2011 and currently stands at $6.3 billion, just 10 per cent above the annual low, while average short interest is only 1.8 per cent, according to Data Explorers. The Long-Short ratio stands at 11.12, meaning that longs outnumber shorts by just over 11 times.

It is a bit of a muddled picture, but one thing is clear; in a volatile, low interest rate environment, custodians are finding themselves needing to adapt.

In the past few years, KAS Bank has shifted from being a lender only to now becoming a borrower for clients. The market is not at pre-Lehman levels, although slowly and steadily business is coming back and borrowing has become necessary in order to cover the needs of internal clients, explains Beta Steiner, head of securities lending for the custodian.

Steiner started out her career in trading as a market maker in the open outcry pit at the Amsterdam Stock Exchange, which was founded in 1600 and is regarded as the oldest in the world. Shortly after, she moved to securities lending, found it to be a perfect fit and has been with KAS Bank for 11 years. In September 2011, she became the head of the securities lending desk for both equities and fixed income.

KAS Bank's biggest clients are insurance companies and pension funds while on the borrower side, it deals mostly with banks and brokers. And though the Dutch market is small, clients are some of the largest parties out there, says Steiner.

The biggest difference between the Netherlands and other markets such as the UK or Germany is that banks tend not to be as aggressive towards competitors as can be seen in other countries. Because there are not many participants in the Netherlands, KAS Bank has a close relationship with most of them, Steiner notes.

The biggest change since the Lehman crisis and throughout the subsequent European debt crisis has been a greater emphasis on fixed income, she says. As implications of regulations such as Basel III dawn on the industry, fixed income is becoming more important than the equities side of the business, particularly for quality government bonds.

"I think there is going to be even more need for triple-A government bonds and we see opportunity to lend them out on even higher levels than now, but on the challenges side, we see that in general there is going to be less demand for stocks. Of course, being a lender we want to lend out as much as possible. In general, regulations present both opportunities and challenges in terms of business, but they will also provide transparency in the market and I think we can all benefit from that," Steiner says.

Another notable change is that lenders are becoming more specific about which collateral is acceptable from a narrowing field of choice. In addition, they are scrutinising the costs of business far more.

Prior to Lehman, the securities lending market was far different from the one we see today. In the past borrowers were willing to borrow as much as possible, but now they first look at the costs involved and if it is worthwhile trading them taking the risk involved into consideration. These days, they are very strict on what they would and would not like to trade mostly depending on the yields and costs involved," says Steiner, adding that another impact on the market has been tax regulations which restrict dividend arbitrage trading. However, short selling bans have not impacted KAS Bank as much because client demand to borrow for reasons outside of short selling remains strong.

Going into 2012, she sees increased costs for trade finance on the back of continuing Basel III regulatory requirements, with fixed income in particular becoming more expensive to borrow.

Specific to the Netherlands, Steiner also mentions that pension funds in general in the market are facing capital ratio requirements that could hit the securities lending industry. Pension funds are required to keep a 105 per cent coverage ratio, but with volatile markets and low interest rates that has been a struggle. Currently pension funds have coverage ratios of between 90 to 130 per cent.

"In a way, that is going to hit securities lending, it all depends on what pension funds will feel is going to be important for them. In general, revenues coming from securities lending is only a tiny part of their business model. Going forward it is a challenge to get them involved whereas they have a lot of other things to focus on at this point besides securities lending," she says. "For obvious reasons this is a shame to us and the whole lending business, but is understandable from their point of view."

A spokesman from the Dutch Association of Company Pension Funds explains that funds that were in a position of undercover as a result of the crisis in 2008 had to make a recovery plan in which they make clear how they will get on track to be above 105 per cent again by the end of 2013. Funds that run behind schedule as of the end of 2011 have to announce possible cuts that may take effect in April 2013. The issue is being hotly debated in Parliament.

Pension problems

As in much of the world, the pension fund industry in the Netherlands is facing a squeeze from many sides. Retirees are expected to tap into pension benefits at historic levels but markets continue to slump. As a result, pension funds are challenged to fund liabilities. Moreover, securities lending returns aren't what they might have been leading up to Lehman's collapse, explains Christopher Holzwarth, senior managing director and head of global sales at State Street.

Before coming back to Boston, Holzwarth was based in London and responsible for business development in EMEA and Asia Pacific regions. He notes that though geographically the Netherlands is small, the country is home to one of the biggest pension fund industries in the world. Consequently, the Lehman collapse had a dramatic impact on business.

"Pension funds in the Netherlands, because they are so big, have traditionally seen very high returns from securities lending. Since 2008, which was the peak earnings year, returns have deteriorated both because of the state of the market and an increase of risk aversion," he says, adding that clients may be more comfortable operating a more conservative programme and choosing to forgo the returns they had become accustomed to.

Adding to the squeeze, the dividend arbitrage trade too has narrowed as a result of tax harmonisation rules across Europe and it is expected to continue to shrink to fewer markets, he notes.

Some pension funds are adapting to these challenges by redefining the scope of their operations. One notable shift in the pension fund landscape has been a kind of "rebranding", Holzwarth explains. Instead of continuing to operate as asset managers for a specific industry sector, they are branching out to become more like traditional asset managers, overseeing not just a pension plan for their own industry but also managing money on behalf of other Dutch pension plans from a different industry sector.

Meanwhile, as operations become more complex and risk averse simultaneously, pension funds which had been running their own securities lending programme are increasingly moving towards outsourcing either some or all of it, he adds.

"There is definitely a view by many of the large plans that because there may have been issues with their in-house lending programmes and issues generally in the market, they may not be best placed to manage this function in-house and might want to look to outsource to the larger providers in the market. They are asking, can this be done more efficiently and effectively while still generating substantial returns?" Holzwarth says.

Outside of the pension world, there are also quite a few large asset managers, such as insurance companies and traditional asset managers, which are also considered progressive and sophisticated investors. Even small and mid-size firms tend to be well versed in the securities lending market.

"Across Europe, we have seen interest in securities lending on the rise again generally. There was a quiet period in 2009 and 2010 when clients were trying to figure out what they wanted to do. They may have scaled back their programme, suspended lending or pulled out of lending completletely, but over the course of 2011 and now into this year, many clients are getting more active again and that holds true for the Dutch market. Whether they are going to outsource it or do some of it themselves, we have seen all of the above," Holzwarth says.

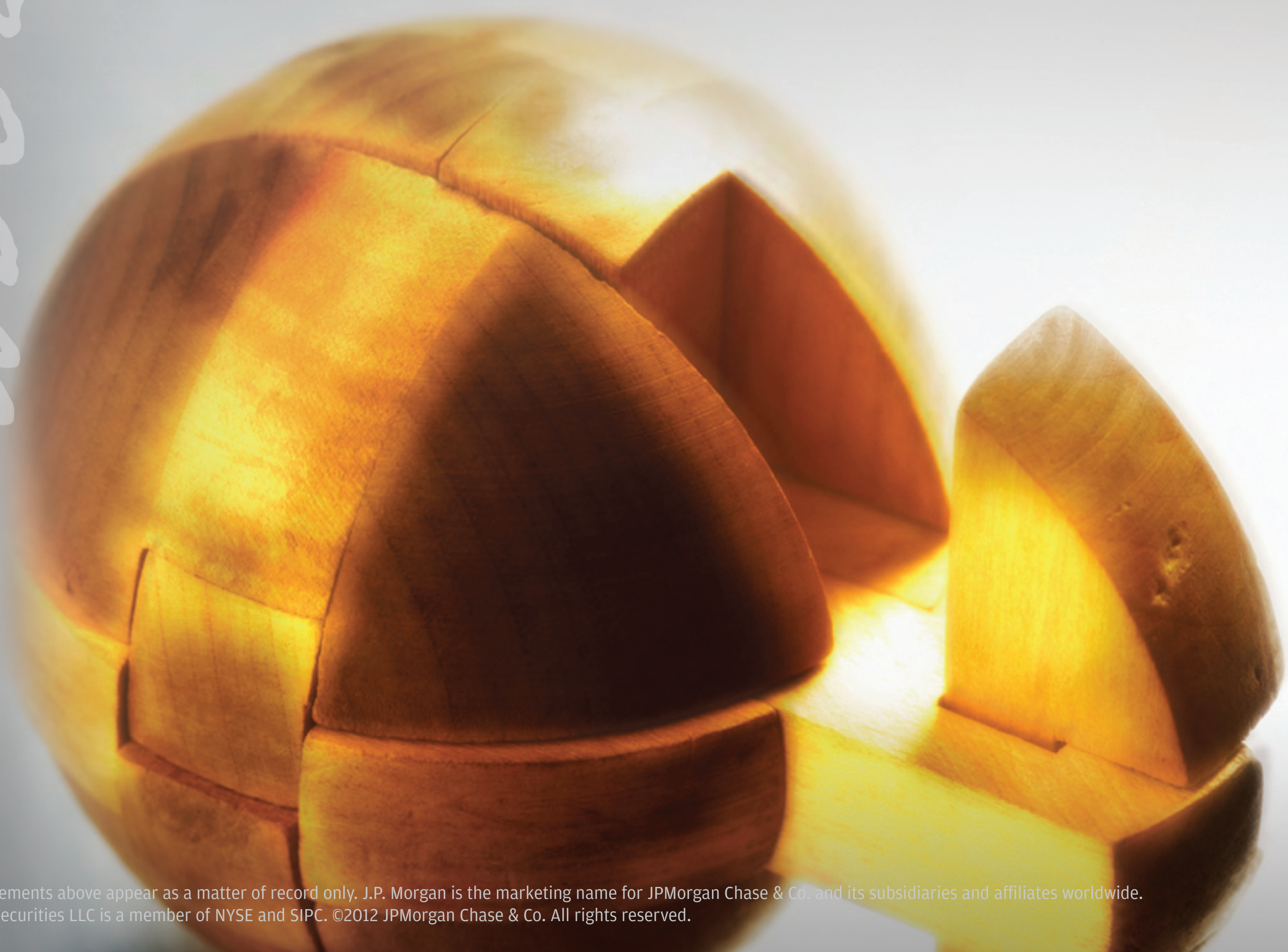
Fixed income demand?

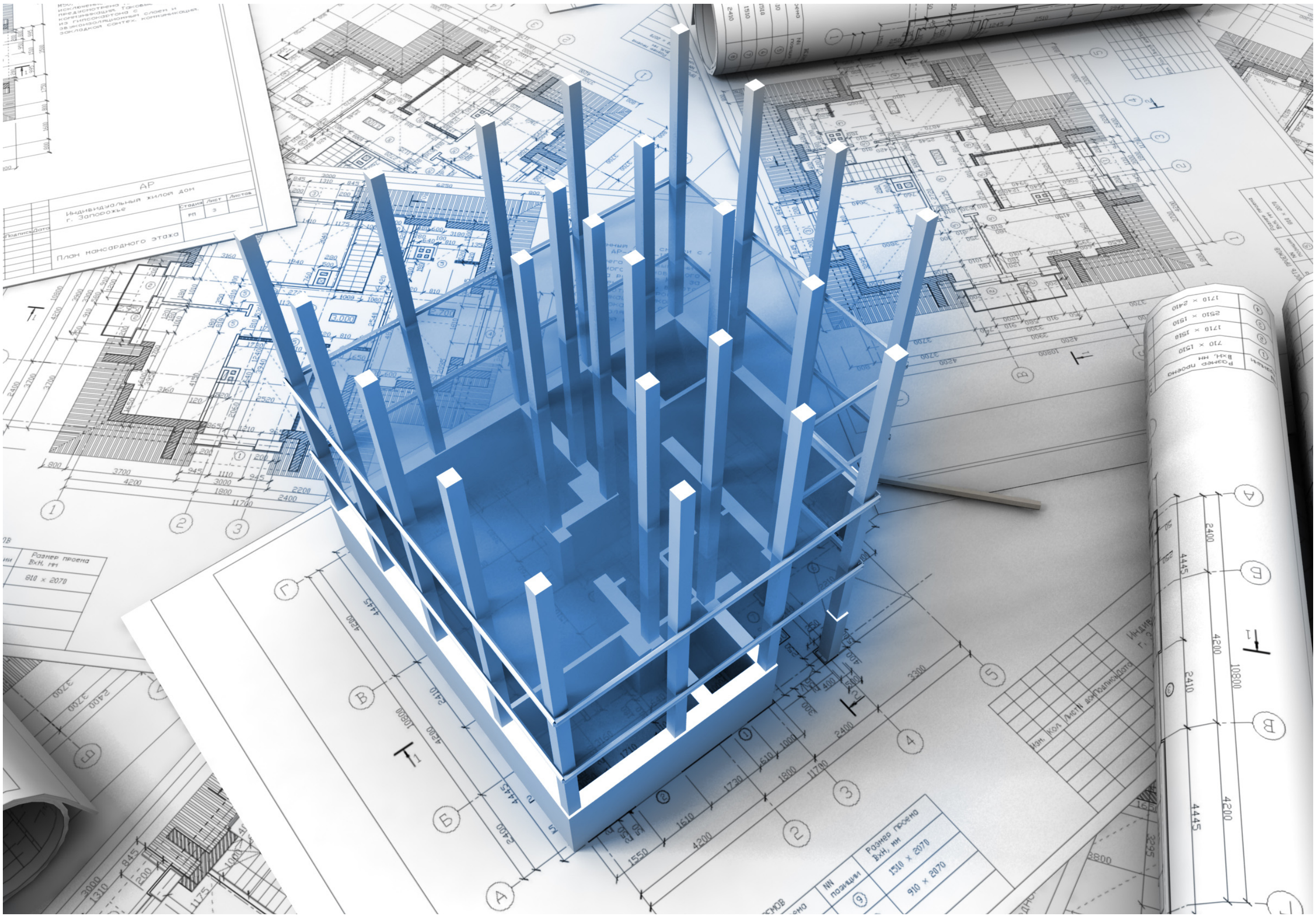
Though quite a few market participants report a significant increase in demand for fixed income, beneficial owners are struggling to generate enough return to make lending worthwhile in a low interest rate environment, which is likely to continue. Meanwhile, with clients opting out of cash collateral or being conservative in how they will reinvest cash collateral, spreads are limited.

"It is sort of a mixed bag of what is going on in the fixed income markets. The bigger piece of it is that many clients aren't lending because it is harder to generate a return in these markets than it has been traditionally. The optimistic outlook is that when interest rates change it will pick up again," he says.

The flipside is that for certain markets in Europe, due to instability and volatility, some government bonds are highly desirable to borrow depending on the investment objectives of the fund. The other demand factor could be a flight to quality, though Holzwarth does not see this happening at the same fever pitch observed after the Lehman collapse.

Equity markets continue to remain stable and clients are still seeing good returns, even with a very conservative approach to collateral management, Holzwarth adds. **SLT**





Collateral dispatch office

Stefan Lepp, CEO of Clearstream's German CSD and head of global securities financing for both the ICSD and CSD, talks about the strategies the company is pursuing to support others in improving their liquidity management

ANNA REITMAN REPORTS

If there is one common theme among the numerous conferences and in recent research studies on the securities lending industry, it is that high quality collateral is getting scarcer and more costly.

There are well-known regulatory and industry dynamics contributing to this situation: sovereign downgrades, increasing demands for secured loans as a result of understandable risk aversion, the looming Basel III liquidity ratio regime, the push to OTC clearing, the list goes on.

SLT: Can you tell me about Clearstream's global collateral management partnerships?

Stefan Lepp: We have roughly 20 years of experience in the collateral management space and we decided to offer this know-how and our system to third parties. In July 2011, the Brazilian CSD CETIP was the first infrastructure to go live with our collateral management outsourcing service. Since then, Australian ASX Group and Strate, the South African CSD, have signed an agreement with us targeting the launch of such service for their domestic market. The goal of this cooperation is to enable our partners in supporting their domestic customer base in collateralising, for example lending positions on a completely automated basis. Initially, the whole setup is domestic: Local banks can cover their domestic exposures with domestic assets. But in the second phase of the partnership – which we have started with CETIP – they can also combine assets in the home market with international assets that they have with Clearstream. So it will be a combined and much larger liquidity pool which will put our partners in a position to cover exposures of their customers in the domestic market. This reduces over-collateralisation significantly as they can go for the "cheapest to collateral". And as fragmentation is decreased, opportunity costs will be brought down increasing the efficiency in the back office of our partners' customers.

SLT: You are also trying to increase the kind of assets that can be accepted as collateral, can you tell me more about that?

Lepp: As collateral is a scarce resource, we are constantly looking for assets which we can make collateral-eligible. Investment fund shares are an example: we are looking into introducing selected money market funds as collateral with substantial turnover and daily market prices, so they can be evaluated properly. We have also introduced equities for a triparty collateral solution – and now, too, for securities lending.

The model we have developed for our strategic partnerships strengthens their local markets because we are not demanding the transfer out of domestic assets. This is why regulators are very much in favour of this model.

We are also working with DTCC to investigate to use registering bilateral loans as collateral. DTCC is very active on syndicated loans, but there is very little you can do with them. It's actually paper that remains immobilised in the vaults and gathers dust. We want to mobilise this dormant paper and this comes back to the idea of widening the range of segments to be used as collateral.

First, the loans are registered, initially in the US and then in Europe. For example, a $10 million interbank loan with a three-year term results in such document; what we are doing is registering this paper in the system and once it is registered, it can be administrated.

This leads to balance sheet relief but also, if it is identified with, for example a kind of ISIN, it could be treated in a similar way as, for example Eurobonds. Then the question is: how do you value such a document? That is what we are working on right now. We need to have a clear, transparent and pragmatic approach in terms of operational processing, which is accepted by the industry.

So next to equities and investment funds, we might have these bank loans, which is potential collateral, but right now is lying dormant in the vaults of global financial institutions.

We expect to have the loans ready for registration and administration in 2013, but in terms of being eligible for collateral, we will need regulatory approval, market commitment and a clear logic for valuation – so that will take a bit longer.

I believe the market is ready for this. Quality collateral is drying up, which makes such a product that makes collateral available from dormant paper highly welcomed.

SLT: Apart from a wider variety of collateral, you are also working on "dispatching" it more effectively. Can you tell me about the process?

Lepp: That brings me back to CETIP. Our partners originally approached us with the request to develop a system, which can allocate collateral to cover exposures in their domestic market. They realised that developing their own system would take a long time, so it really came down to a time-to-market and a cost issue for them. We have been able to come up with a model that fits their requirements as the domestic assets don't leave Brazil. Soon after, we announced a partnership with ASX in Australia and just recently with Strate in South Africa too. I am convinced that more markets will follow this model. Although each market has different business drivers and needs, at the end of the day, the overall idea is always the same: optimising the use of collateral.

What differentiates us from other service providers in the collateral management space is that we allow the securities they allocate as collateral to stay in their domestic environment. We have understood that there are markets out there which are simply not in a position to transfer domestic bonds out of their home market for regulatory, political or efficiency reasons. The assets have to stay in the local market.

So we said, 'OK, if the collateral cannot come to us, then we go to the collateral'. And we developed the functionality to allow these domestic infrastructure providers to keep all the assets in their home market under local regulations, terms and conditions. Clearstream does not even have to appear as a service provider; we perform the allocation algorithms in the background and provide the respective settlement instructions.

The model we have developed for our strategic partnerships strengthens their local markets because we are not demanding the transfer out of domestic assets. This is why regulators are very much in favour of this model.

The phase we are currently working on with CETIP is to add, next to domestic portfolios, international assets of their underlying customers to cover domestic exposures. Our system at Clearstream has the intelligence to look across the accounts at CETIP and Clearstream in order to determine the cheapest to collateral on an optimised basis.

The next phase we are working on right now is to support the Brazilian market in covering global exposures because these banks are also active with clearing houses all over the world. Right now, there is constant over-collateralisation in different locations to be prepared for peaks. According to a recent Accenture study, this over-collateralisation and the resulting inefficiency costs some €4 billion to the industry on an annual basis. We are building more links to CCPs, to clearing houses, stock exchanges and trading platforms to act on a "power of attorney" basis so that we can transfer collateral quickly. On top of that, we built links with central banks across the globe to give our customer streamlined access to central bank money, which is key for almost all of our customers.

SLT: How exactly could this impact the securities lending industry?

Lepp: The situation is very similar. In some markets, customers have assets with a CSD while in others they hold the assets with an agent bank. Clearstream has a model in place which allows its customers to keep those assets in the same place but with the benefits of collateral management. Going forward, market infrastructures which we are partnering with can collateralise lending positions on a completely automated basis.

SLT: That seems like a lot of paper flying around a lot of places. What does risk management look like, particularly as you diversify collateral type?

Lepp: The residing risk is not something that Clearstream will take control over because we are not the risk manager of the underlying transaction. A CCP would never outsource this function, so our partners stay in charge of risk estimation and management. They simply tell us: what is the exposure and how should it be collateralised? And then we will help them. **SLT**

Stefan Lepp
CEO, Clearstream's German CSD and head of global securities financing for the ICSD and CSD

Taking advice?

Are short sellers swayed by analyst recommendations, asks Data Explorers' Will Duff Gordon

MARKET WATCH

We use securities lending flows to highlight where short sellers follow convention or go against Wall Street analyst expectations.

Stocks highlighted include: American Greetings Corporation (NYSE:AM), Global Power Equipment Group Inc. (NASDAQ:GLPW), Main Street Capital Corporation (NYSE:MAIN), IXYS Corporation (NASDAQ:IXYS), The Pep Boys - Manny, Moe & Jack (NYSE:PBY), IPC The Hospitalist Company, Inc. (NASDAQ:IPCM) and SonoSite, Inc. (NASDAQ:SONO).

Investors "don't care where a stock's been, just where it's going" as such, we look at two different equity sentiment indicators to see how shares perform given bullish or bearish investor expectations. In summary, we find that short sellers and broker recommendations tend to agree with each other. Yet, this is not true in all cases where bearish sentiment is expressed, as short sellers often look to cover to take profits.

Macro view

Looking at US equities with market cap over $400 million over the last quarter, we assessed how share prices have performed in relation to varying broker recommendations. It is not surprising that shares with relatively bearish broker recommendations have underperformed in recent months. Short sellers are another sentiment indicator and we find they tend to agree with average broker recommendations – but not always. Using S&P Capital IQ to commingle Data Explorers short interest content alongside earnings estimates, the chart below shows the average short interest over the different broker recommendations ranging from 1 (Strong Buy) to 5 (Strong Sell) with the trailing three month price performance. US equities have an average broker rating of 2.2 and see 4.3 per cent of their shares out on loan.

While short interest increases as brokers become more bearish about a stock's prospects, the correlation is not as smooth as might be expected. Shares with a "Strong Buy" rating see average short interest at four per cent, which increases to 5.4 per cent for shares with a "Hold" rating.

Yet short sellers and brokers seem to disagree at the extreme end for shares with a "sell" rating, which see short interest at less than two per cent, well below the average of 4.2 per cent. However, this group comprises only 19 shares. From a performance side, both short sellers and analysts have been able to uncover underperforming shares.

Comparing to an average market return of 10.1 per cent in the last three months, shares with a "Strong Buy" rating have seen their share price increase by 15 per cent compared to a 9.6 per cent return in shares with a "Hold" rating of 3.

Short interest in individual names

We ran an S&P Capital IQ screen to identify the shares with the largest downgrades in broker recommendations over the last three months (See Table).

Short sellers tend to agree with analysts. American Greetings Corp, which saw its share downgraded to hold by analysts in the last three months, has seen its short interest rise to 21 per cent of shares outstanding (See Chart).

Most of the names on this screen also see greater than average short interest of four per cent of total shares, with the exception of Global Power Equipment group, Main Street Capital and semiconductor company IXYS, which saw its shares collapse 15 per cent last week.

Short covering in the face of analyst downgrades

Looking at the changes in short interest from this screen, we find that short sellers have been reducing their exposure in car care chain, Pep Boys by around a quarter to 8.3 per cent in the face of broker downgrades (See Chart).

We also see short sellers have covered their positions in hospital chain, IPC in recent weeks as the share price collapsed amid further downgrades. Ultrasound acquisition target, Sonosite has been subject to merger arbitrage as shorts have covered by halving their positions to 7.5 per cent of the total market cap as the shares have increased almost 80 per cent in the past three months. **SLT**

Will Duff Gordon
Research director
Data Explorers

Shares With Bearish Changes in Borker Recommendation

Company Name	Ticker	Short Interest	3 Month Change	Average Borker Recommendation	3 Month Change	3 Month Price Performance
American Greetings Corp.	NYSE:AM	20.97	6.14	3.0	1.00	-6%
Hyperdynamics Corporation	NYSE:HDY	14.36	0.70	2.5	1.00	-35%
Micromet, Inc.	NasdaqGS:MITI	7.83	-1.43	2.9	0.98	78%
SonoSite Inc.	NasdaqGS:SONO	7.47	-7.34	2.7	0.87	36%
Global Power Equipment Group Inc.	NasdaqGS:GLPW	3.04	0.02	2.5	0.83	-2%
Pep Boys - Manny, Moe & Jack	NYSE:PBY	8.28	-2.58	2.7	0.81	34%
Main Street Capital Corporation	NYSE:MAIN	3.56	1.79	2.6	0.80	23%
IPC The Hospitalist Company, Inc.	NasdaqGS:IPCM	11.53	-5.08	2.6	0.74	-23%
Progress Software Corp.	NasdaqGS:PRGS	4.38	0.34	2.3	0.73	12%
F.N.B. Corporation	NYSE:FNB	10.40	-2.62	3.0	0.70	14%
IXYS Corp.	NasdaqGS:IXYS	3.24	-0.08	2.0	0.67	-5%
VirnetX Holding Corp	AMEX:VHC	14.33	-1.10	1.7	0.67	14%
Meritage Homes Corporation	NYSE:MTH	8.38	0.58	3.1	0.67	36%
Quad/Graphics, Inc.	NYSE:QUAD	8.75	3.54	3.0	0.67	-14%
NBT Bancorp, Inc.	NasdaqGS:NBTB	3.91	0.12	3.0	0.67	7%

2012

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ITAS 2012 International Transfer Agency Summit

Location: Luxembourg
Date:29 February - 1 March 2012
www.informaglobalevents.com

Last year, the 10th Anniversary of ITAS saw 250+ attendees at the event. The positive feedback led all involved to declare it a resounding success in terms of catching up with business partners, listening to and debating with some of the leading figures in this industry, and having great fun at the evening functions. Already there is great anticipation in the market for coming along to ITAS 2012.

9th Annual PASLA RMA Conference on Asian Securities Lending

Location: Taiwan
Date: 6-8 March 2012
http://www.rmahq.org/securities-lending

Keynote Speaker - Robert A. Jaeger, senior investment strategist, BNY Mellon Asset Management, Author of "All About Hedge Funds: The Easy Way to Get Started"

Securities Financing Forum London

Location: London
Date: 20 March 2012
www.dataexplorers.com

Join the leading practitioners in the Securities Financing industry for a day of debate and insight into this market. Last year the London forum sold out quickly and was attended by close to 300 delegates. This is a date not to be missed.

Securities Financing Forum New York

Location: New York
Date: 22 May 2012
www.dataexplorers.com

The Data Explorers Securities Financing Forums bring together the world's most influential securities financing professionals, including beneficial owners, hedge funds, prime brokers, agent lenders and regulatory experts; all of whom come together each year to engage in debates that will help define and drive the future of securities financing

Industry appointments

Southwest Securities has announced that SVP **Anton Berends** is the new head of Clearing Services and will be responsible for oversight of the principal broker-dealer's securities lending business.

"Anton has been a valuable member of Southwest Securities' team for over a decade and has earned the respect of both colleagues and clients throughout that time," said James Ross, CEO of SWS Group, Inc. "Anton began transitioning into this new role many months ago and his broad experience and industry knowledge uniquely position him to lead our clearing and securities lending businesses."

A 13-year veteran of the firm, Berends worked in Risk Management with former head of clearing services Paul Vinton until Vinton's retirement in December 2011. Prior to joining Southwest Securities, Berends was a business analyst with Triple-I of Colorado. He began his career in the securities industry in 1992 at Raymond James & Associates where he served in a variety of roles.

State Street Global Markets has appointed **John Minderides** as head of its portfolio solutions business for EMEA. He will be based in London and report to Nicholas Bonn, EVP, who has been appointed global head of State Street's portfolio solutions activities worldwide, including transition management and equity trading business.

State Street Global Markets is the investment research, trading and securities lending arm of State Street Corporation. Prior to this role, Minderides was head of product and research at ITG Europe, where he created the portfolio trading and research division. He was also responsible for establishing the transition management team at Barclays Global Investors and was managing director and global head of transition management at JP Morgan with responsibility for teams in London, New York, Sydney and Tokyo.

"With more than two decades of experience, John's broad industry knowledge will be vital for ensuring we continue building our industry leadership across the EMEA region," said Bonn, a 19-year veteran of State Street and founder of the company's transition management business.

EquiLend Europe has added **Rowena Brown** to the client relationship management (CRM) & sales team, where she will be responsible for working with existing and prospective clients. Brown will be based in London.

"I am very excited to be joining the EquiLend team and delighted to work with so many outstanding people," stated Brown, "I am especially looking forward to the opportunities and the challenges the role brings."

Laurence Marshall, managing director and COO of EquiLend added, "We are delighted to welcome Rowena to EquiLend with her extensive business knowledge and experience that she brings. Her expertise with front-to-back product flows will be of great benefit as we expand our services for clients and develop Trade Optimisation across Europe and Asia."

Brown joins the company from SecFinex where she held a position of senior sales representative. She also brings with her over 10 years experience covering custody, securities lending and collateral management.

Warren Maynard, State Street Canada's vice president account manager and sales - securities finance, has left the company after seven years. Maynard had overall responsibility for the relationship management of the bank's Canadian clients in its securities lending programme.

DTTC has named **Mark Davies** as vice president for Data Business Development focused on the clearing house's involvement in the Legal Entity Identifier (LEI) programme in Europe. He joins DTCC from the Royal Bank of Scotland (RBS), where from 2008 he served as head of Reference Data within Shared Services Finance. He has also held various positions at Barclays Capital and Credit Suisse First Boston.

In his new role, Davies will be based in London and responsible for strategy and liaison activities in Europe regarding the LEI project.That will include participating in the development of a distribution strategy, serving as a subject matter expert on the LEI business with regulators and industry committees and representing DTCC in customer meetings, customer forums and regulatory meetings. He will report directly to Ronald Jordan, DTCC managing director and chief data officer, who is based in New York.

"We are delighted to have someone with Mark's expertise and experience join DTCC to assist in this critical international effort," Jordan said. "Not only does Mark have a long history of working with data management services, he has played a critical role on the industry's LEI steering committee representing the Royal Bank of Scotland in developing the requirements for the LEI project, and we know he will continue to provide continued leadership in his new role with DTCC."

LEI is a global programme designed to create and assign unique identifiers to every financial organisation that engages in a financial transaction. Regulators need LEIs to better gauge systemic risk, and risk managers at financial institutions need LEIs to better understand and aggregate counterparty exposures and risk.

A group of industry associations has recommended to regulators a group of organisations to provide the LEI solution, with DTCC as the proposed facilities manager for project. DTCC has responsibility for gathering, validating, storing and distributing various data on each legal entity. The other organisations recommended include the International Organisation for Standards (ISO), the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and the Association of National Numbering Agencies (ANNA). **SLT**

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9th Annual Conference on Asian Securities Lending

6–8 March 2012 | W Taipei | Taipei, Taiwan

Co-sponsored by the Pan Asia Securities Lending Association (H.K.) and the Risk Management Association (USA), the first industry-wide co-sponsored conference in Asia developed by securities lending and borrowing professionals for securities lending and borrowing professionals.

The business program will include discussions on

- Informational Short Selling and Institutional Framework Round Table
- Taiwan Securities Borrowing and Lending Market Update and Forum
- The Development and Opportunity of Securities Finance in China
- Asia/Pacific Securities Lending Forum
- Securities Lending Tutorial

On Wednesday, 7 March the Keynote Speaker Robert A. Jaeger, Senior Investment Strategist, BNY Mellon Asset Management and Author of "All About Hedge Funds: The Easy Way to Get Started", Dr. Jaeger will speak to the opportunities and risks in the popular hedge fund strategies (Leverage, short selling, and hedging), how hedge funds fit into the global financial system, how hedge funds fit into a balanced stock/bond portfolio and the legal, regulatory, and tax issues.

For more information about the conference, registration, room reservations, exhibiting and sponsorship opportunities visit the RMA Website at www.rmahq.org or email Kimberly Gordon at KGordon@rmahq.org.

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