SLT
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Concern voiced over ESMA draft

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With one comment period for ESMA's latest standards on short selling and CDS rules ended and the next one released, participants have spoken out over the short time frame provided while also expressing concerns over definitions contained in the technical advice.

In the first set of published responses for the comment period beginning 24 January and ending 13 February, nearly all of the firms representing stakeholders of the borrowing and lending community pointed out that the compressed timetable may impede the European financial markets regulator's aims.

"In the case of far reaching legislation, ESMA should request sufficient time from the Commission, to enable it to deliver the best possible advice to high quality and credible standards," said the London Stock Exchange Group, adding that the European Commission has the right to extend by six months adoption of the act and that ESMA "should point this out".

Outside of such criticisms, published responses also targeted rules which could have unintended consequences, specifically, that securities lending desks will not be able to provide locate confirmations for the same entity's trading desk.

"It appears that parties would either need to have true borrow arrangement with a same entity desk...or they would need to relocate their lending or repo desks to a separate legal entity subject to authorisation/registration," explained law firm Herbert Smith.

In general, industry responses called for more clarification on which actors could be considered third parties under this particular definition as well as expressing concerns that such measures run the risk of creating unduly complicated corporate structures.

Short selling regulations are due to enter into force in November and will then be binding across all EU member states. An open hearing is scheduled for 29 February on a further consultation draft, which tackles issues such as share ownership definitions and threshold calculations for short sale reporting requirements. The comment period ends 9 March. ESMA expects a final report and submission of the draft advice to the Commission by mid-April.

NEWS**IN**BRIEF

Euro short selling bans lifted

Spain's financial regulator is the latest to lift a short selling ban on financial stocks, citing improved market conditions, according to various media reports. Disclosure requirements of significant short positions will continue to be in force.

French and Belgian financial regulators have announced that short selling bans on selected stocks will not be extended.

France's Financial Markets Authority (AMF) said, "The provisions prohibiting any creation of a net short position and increase of an existing one in relation to French equity securities of the financial sector...came to an end on Saturday 11 February 2012. As a consequence thereof, the prohibition of short sales...is lifted."

read**more** p3

Illinois state agency considers third party options

The Illinois Teachers' Retirement System (TRS) has announced it is seeking proposals from outside vendors in a bid to boost its securities lending returns.

After a formal review looking at third party securities lending, estimates showed that additional revenue could climb as much as 30 per cent if prudent changes are made, said TRS. Last year, its securities lending programme generated $17.7 million.

The TRS investment staff anticipates the RFP process will be concluded by August.

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Euro short selling bans lifted

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The announcement comes hot on the heels of an agreed Greek austerity package, as the indebted country begins talks to reach a bond restructuring agreement with creditors in order to secure a second €130 billion bailout.

The 10 insurance companies and financial stocks affected by the French ban were: April Group, Axa, BNP Paribas, CIC, CNP Assurances, Crédit Agricole, Euler Hermès, Natixis, Scor, Société Générale.

AMF added that regulatory disclosure requirements on equity securities implemented this month are in effect and that any investor must be in a position to deliver sold securities within three trading days.

Belgium's financial regulator also announced that the country's short selling ban on specific stocks is lifted though a naked short selling ban would remain in place and significant short positions would be subject to reporting requirements, according to various media reports.

Bans in Italy and Greece remain in place.

Short sellers target love

Online dating providers with easily replicable business models and tenuous outcomes have attracted interest from short sellers, according to Data Explorers.

Just in time for Valentine's Day, The Economist presented scientific research casting many of the claims of online dating into doubt. The heart of the matter, wrote Data Explorers, is that "the choice offered by online dating can be overwhelming and in the end outcomes might not live up to expectations. It may come as no surprise that this hugely competitive industry has been targeted by short sellers".

The securities lending analytics firm identified that the running theme across the three listed online dating providers it looked at seems to be that companies exploit love seekers' differing attractions by making several versions of what is essentially the same site.

InterActiveCorp, operator of match.com and chemistry.com, has seen short interest grow steadily over the last year from six per cent of total shares to 14 per cent. FriendFinder Network, operator of friendfinder.com, has seen short interest grow steadily to 2.3 per cent, which represents nearly all of the available supply, and the company's shares have lost over two-thirds of their value since its IPO last year.

Lastly, Spark Networks, operator of jdate.com, has relatively low short interest, with 1.2 per cent of shares on loan, but Data Explorers noted that this number has jumped in recent weeks on the back of a share price rally in the fourth quarter of 2011.

"Matters could be further exacerbated should companies like Facebook or Google offer matchmaking services free to their existing communities," Data Explorers added.

Hedge fund flows positive in February

Hedge fund flows advanced 2.3 per cent in February, according to the GlobeOp index. Cumulatively, the index for the month stands at 142.6 points, an increase of 2.25 points over January 2012.

“Net flows were positive, against a backdrop of record low outflows,” said Hans Hufschmid, CEO, GlobeOp Financial Services.

Over the last 12 months, the hedge fund administrator’s Capital Movement Index has advanced 13.5 points.

Securities lending pops up at AFME liquidity conference

Securities lending operations and repo markets need to “come back” to successfully deleverage the system as a whole, said a leading economist at AFME’s European Market Liquidity Conference in London.

A panel of economists discussed the unintended consequences to the financial system as a result of pressures on banks to deleverage some $3 trillion. One panelist noted that taking “financial plumbing” such as securities lending and repo markets into account bumped that figure up considerably.

“Central banks tend to look at the monetary angle...but looking at repo and securities lending operations, those numbers are as big. Inflation and monetary policy [fail to take into account] that the world is a lot more complex than that... the financial plumbing aspects of deleveraging, which is in a way the system-wide use of all sorts of collateral to reduce market risk, need to be factored in...those pieces need to come back, that is what will complete the system,” he said.

In 2006, the Federal Reserve stopped publishing figures tracking M3 money supply, which includes repo and securities lending market paper. The Bank of England and ECB continue to track it.

Probably the hottest topic during the conference was Greece’s debt crisis, about which a wide variety of lively opinions were expressed. However, some speakers noted that Greece is not the problem, unwinding the problem is going to be the problem. Thought the LTRO is widely viewed as a positive development, it is also seen as a measure which delays facing political pain.

Clearstream GSF services up eight per cent in January

Global Securities Financing Services at Clearstream lifted eight per cent year-on-year, reaching €594 billion monthly average outstanding in the first month this year. The combined services include tripary repo, securities lending and collateral management.

In Investment Funds services, 480,000 transactions were processed, a five per cent decrease over January 2011. The value of assets under custody held on behalf of customers decreased four per cent to €11 trillion. Securities held under custody in the international business decreased one per cent to €5.9 trillion while domestic German securities dropped six per cent to €5.1 trillion in January 2012 compared to the same month last year.

In January 2012, three million international settlement transactions were processed, an 11 percent decrease over January 2011. Of all international transactions, 80 per cent were OTC transactions and 20 per cent were registered as stock exchange transactions. On the German domestic market, settlement transactions reached 6.6 million, nine per cent less. Of these transactions, 67 per cent were stock exchange transactions and 33 per cent OTC transactions.

Which short selling ban is least damaging?

A new academic study argues that a ban on naked short selling is the least damaging to market efficiency of all short selling regulations.

Looking at European regulations between July 2008 and June 2009, researchers from the University Libre de Bruxelles found that covered short selling bans raise bid-ask spreads and reduce trading volumes, disclosure requirements raise volatility and reduce trading volumes while naked short selling bans raise both volatility and bid-ask spreads. In addition, the researchers assert that no regulations are effective against price decline.

“Overall, all short sale regulations are detrimental to market efficiency. However, naked short selling prohibition is the only regulation that leaves volumes unchanged while addressing the failure to deliver. Therefore, we argue that this is the least damaging to market efficiency,” the study said.

Researchers analysed fourteen European markets over the one-year period, studying the ef-

fects of a variety of regulatory regimes on market efficiency. They compared the effects of three categories of short selling regulations – prohibitions on covered and naked short selling, naked short selling only and requirements to disclose short positions to the market's regulator - on individual stock's bid-ask spreads, intraday volatility, trading volume and weekly returns.

Though covered short selling prohibitions are associated with higher returns and lower intraday volatility, the effects are transitory the study showed. Meanwhile, naked short selling bans permanently raise intraday volatility and bid-ask spreads but have no impact on either volumes or stock returns, even in the short run. Disclosure requirements, meanwhile, reduce trading activity and increase volatility, also permanently.

Still, the study does point out that disclosure regulation regimes result in lower bid-ask spreads, as was the case during the financial crisis, when information to the market is likely most beneficial to efficiency. This could indicate that disclosure requirements increase reporting costs which uninformed short sellers shy away from.

"Hence, sell trades become more informative because they more likely originate from well-informed short sellers. Lower bid-ask spreads could also indicate that the informational benefit of disclosure outweighs the informational loss stemming from missing short sales," the study said. Other findings show that in the long run, stock returns are insensitive to short selling regulations though there is a short-term overvaluation effect, which can be "exploited by market authorities in crisis situations".

"As far as market efficiency is concerned, our results thus raise serious doubts on the adequacy of both the existing national regulations and the pan-European proposed harmonisation currently under discussion," noted researchers.

Mixed bag for securities lending in M&A trends

Global economic uncertainty and regulatory change will continue to impact M&A in the coming year, according to the latest trends insights by Clifford Chance. Despite the unsettled global picture, activity is continuing and, in some areas, the law firm expects to see significantly more confidence in doing deals as the year progresses.

"Once confidence returns, the fundamentals are certainly in place for M&A activity to increase significantly as we move through 2012 and into 2013," said Matthew Layton, global head of Corporate at Clifford Chance. What that might mean for the securities lending market is in question however since one of the prime drivers are significant cash reserves on corporate balance sheets and liquidity in PE funds, which are likely to seek out good deals. If activity leans towards cash deals, opportunities for arbitrage might be limited.

David Lewis, SVP at SunGard Astec Analytics, said that corporations are indeed sitting with a lot of cash on their balance sheets which may be burning a hole in some pockets. He expects that a significant portion of M&A activity will be financed from cash rather than raising debt and as a result, growth may not result in an uptick in the securities lending market.

At the same time, energy, mining and utilities were the most active sectors in 2011, representing some $557.7 billion of the total $2.2 trillion in global M&A. And going into 2012, there is expected to be a continued fight to secure natural resources and energy assets, according to Clifford Chance.

The recent announcement of advanced merger talks between commodities group Glencore and miner Xstrata could be an indication of things to come. Commenting on the deal, Chris Searle, corporate finance partner at BDO, said that the merger is no real surprise given that Glencore already owns 34 per cent of Xstrata and Glencore's IPO last year has now given a public valuation for its shares that can be used in an all share merger. The combined entity will easily be the largest among rivals such as BHP Billiton, Rio Tinto or Anglo American.

According to Astec Analytics data, Glencore had some 105 million shares on loan shortly after the announcement, while short positions on Xstrata dropped about 20 per cent. "I would expect more on loan for Glencore over the next few weeks, but as an all share deal, it is going to be very interesting and potentially very profitable in the lending market," Lewis notes.

Meanwhile, analysts are chiming in on whether this merger, if it overcomes hurdles in the coming months, heralds more such transactions.

"Whether this merger triggers another round of consolidation in the industry remains to be seen, given anti-trust concerns around the world, but other companies may feel forced to merge just to keep up with this new giant," said Chris Searle of BDO.

Global M&A snapshot

Last year, global M&A activity increased 2.5 per cent over 2010 and transactions totalled $2.2 trillion. While 2011 was the strongest worldwide performance since 2008, activity levels declined for each quarter during the year and a number of headline deals collapsed. The second half of 2011 saw a significant decline in M&A as the eurozone crisis reached a feverish pitch – M&A in Asia Pacific dropped 31.9 per cent, European M&A declined 28.7 per cent and the US saw a 9.3 per cent drop quarter-on-quarter.

Cross border M&A remains a continuing trend – deals between individual countries represented 41.5 per cent of global M&A in 2011 and deals between regions are up 19.6 per cent over 2010. The escalating eurozone crisis continues to remain a risk factor to M&A growth.

"The key issues are around liquidity and funding, as all businesses are potentially impacted by banks' exposure to the continuing crisis. Where sovereign debt of Eurozone countries is down-

graded, this has knock-on effects for domestic banks and ultimately for domestic organisations accessing finance or having to refinance. M&A activity is being affected as confidence decreases and the spectre of a double-dip recession in many developed nations increases," noted Clifford Chance.

"The risk of a euro exit by one of more eurozone countries continues to be very low, but buyers and sellers need to be mindful of that possibility, as well as other emergency scenarios, in respect of current and future M&A transactions. Due diligence to assess and analyse key areas of risk where the target operates in a potentially affected eurozone country is advisable," the law firm adds.

Northern Trust says LA lawsuit has "no merit"

Northern Trust has denied wrongdoing in response to a lawsuit filed by the Los Angeles city attorney against the firm and Pension Consulting Alliance over securities lending cash collateral reinvestment losses. LA's city attorney, Carmen Trutanich, filed the suit on behalf of LACERS, the Los Angeles City Employees' Retirement System.

In a released statement, the firm said, "The lawsuit was not filed by LACERS, with whom Northern Trust has an excellent, long-standing and ongoing relationship. Northern Trust has acted as the primary custodian and as a securities lending agent for LACERS since 1991...The facts show that this civil lawsuit...has no merit... As LACERS' lending agent, Northern Trust appropriately invested cash collateral according to LACERS' own guidelines."

The Office of the City Attorney alleges that Northern Trust claimed that investments made by the company on behalf of LACERS were "low risk" or "minimised risk," including conservative, short-term, highly-liquid investments. However, from June 2006 until June 2008, Northern Trust failed to inform LACERS that it had changed its investment strategy in violation of common law fiduciary standards. The company allegedly provided no details of each specific investment in the City's portfolio, including the current market value of each investment.

Other allegations made by the City involve claims that Northern Trust behaved inappropriately to stop a collapse in certain managed investment pools by convincing investors not to pull money, putting the firm's interest above the interest of individual pension funds.

Northern Trust points to the fact that LACERS did not lose money on its securities lending programme and, in fact, has earned tens of millions of dollars over the past 20 years. Moreover, even with losses incurred in 2008, the pension fund is ahead.

In 2008 LACERS experienced unexpected losses in its securities lending custom fund - which it created, established guidelines for and monitored. The losses were mostly due to investments in several fixed income securities. Those securities were highly rated, within investment guidelines set by LACERS, and held by pension funds throughout the country, said Northern Trust.

"The city attorney's suit, brought years after the losses were incurred, is based on hindsight. It is premised on the legally deficient claim that Northern Trust should have predicted unprecedented events even though the markets as a whole had not," the firm said. "We regret that this meritless lawsuit will likely cost the LACERS pension plan, and the city of Los Angeles, millions of dollars in unnecessary legal fees and out of pocket expenses."

The lawsuit seeks full restitution for losses, as well as damages that LACERS sustained as a result of Northern Trust's false claims, civil penalties up to $10,000 for each false claim, and $2,500 for each violation of the Business and Professions Code, and all fees and costs associated with the lawsuit.

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Open Sourced

Citi's David Martocci speaks to SLT about how the provider has evolved its securities lending offering

ANNA REITMAN REPORTS

Over the past thirty years, Citi's securities lending product, OpenLend has grown from a small custodial lender to one of the premier global agent lenders in the business. David Martocci, managing director and global head of sales and client management for Citi's Securities Finance business, describes OpenLend as "an open-architecture securities lending offering that provides clients with a boutique service designed to enhance portfolio performance by delivering customised solutions".

SLT catches up with him at the IMN Beneficial Owners Conference in Arizona to find out more about OpenLend and get some insight into how markets are shaping up as securities lending business drifts back.

SLT: You seem to have had a securities lending role in every bank – why end up at Citi?

David Martocci: Citi was an interesting opportunity. I have a lot of experience in the securities lending business specifically in the third party space. I have previously been instrumental in building third party businesses at J.P. Morgan, Lehman Brothers, Deutsche Bank, and Dresdner. In looking at Citi, I saw a business with exceptional potential for growth in this space. Citi's global presence and the depth of its relationships with many of the world's most important institutions presented a tremendous opportunity for expansion. What also drew me to Citi was the quality of talent of the people and the level of commitment of senior level management to the business, in terms of continuing, developing and growing it.

> Clients are choosing between the benefits of either a custodial or third party programme, they are looking at reinvestment options, lending structures, how they want to lend, what they want to lend, and in what markets

SLT: What was the impetus for developing the OpenLend brand?

Martocci: When I think back and look at why we decided to rebrand, obviously we spent a lot of time with clients and prospects discussing their needs and objectives, how they envisioned the business going forward. At the IMN conference you hear a lot about bundling and unbundling and trends, but honestly I feel that the real driver is what clients are saying. OpenLend was really just about spending time with clients, understanding their needs, and providing them with a securities lending offering that is about choice and developing customised solutions.

SLT: How has this evolved from what securities lending used to be?

Martocci: If you look at how the business was back in the late 80s and early 90s, securities lending was a check box on a custody agreement and clients were placed into boxed solutions which did not offer customisation to their unique requirements. Obviously since then we have come a long way. After everything that has transpired over the last four years, beneficial owners have realised that participating in a programme that is flexible and offers the ability to tailor their programme is really what makes sense. I feel that clients can then go to their management and demonstrate that they spent the time in analysing and structuring a programme suitable for their needs.

SLT: What choices are clients making?

Martocci: We work one on one with our clients to understand what their needs and objectives are. We need to understand the risk and return profile of their institution and how we can adapt our program to fit within this framework. Clients are choosing between the benefits of either a custodial or third party programme, they are looking at reinvestment options, lending structures, how they want to lend, what they want to lend, and in what markets. They are also looking at a combination of various programmes in terms of whether they would like an exclusive, an agent structure or a hybrid. At Citi, we are able to leverage our industrial strength and global expertise in delivering the white glove service which our clients have come to expect.

SLT: How about collateral choices, do you see any trends there?

Martocci: Either way you look at it, whether the client takes cash or non-cash collateral the market trend is all about providing choices for clients. For example, is the client an asset manager? Do they want the cash collateral back or do they choose external managers? If the client chooses external managers and just went through an RFP process and selected someone to manage their medium term fixed income portfolio, for example, that means they went through their board, they went through the approval process and they did their due diligence. Well, if those approvals are OK and the asset manager has a money market offering, why not give the same counterparty the cash collateral to manage? At the end of the day, your securities lending provider could be your largest single asset manager, then the same due diligence should apply.

That is how our programme is structured. But we have always run an intrinsic style programme, so Citi never had pooled investments. We are very fortunate in how the programme was structured and developed. It helped in the tough years that we have just gone through and we continue to refine and develop it as market conditions indicate.

SLT: What might some of the customisation look like?

Martocci: Let's say a client has a corporate bond portfolio with high yield corporates which they are concerned about lending. Customisation is really in finding out what the portfolio manager is concerned with. Are they looking for trading volume or price? So developing a programme for that client based on their needs and making them comfortable based on, for example the last three days trading volume is an integral part of our programme.

SLT: You recently opened an LA office, what was the push?

Martocci: We've developed and grown our business in the Americas in the last few years. The Los Angeles office is about US-based market growth and looking at where our clients are located. We can better service clients by expanding the hours for our relationship management team and Citi has always had a fair amount of business on the West Coast. Looking at the development of business over the last 18 to 24 months, it has made a lot of sense to have the staff out there, both from a relationship management and product sales specialist standpoint.

SLT: Asia is always big news, how is your presence there developing?

Martocci: We've always been there. I see some of these press releases for Taiwan launches but we have been there over five years. So for us, it is about continued expansion. Some of these markets are true and tested so having that footprint is definitely an advantage for our clients and we are taking full advantage. Our recently launched Australia trading and product group has been very successful in expanding horizons and developing new opportunities and business.

SLT: I often hear that one of the challenges in Asia is a "fragmented" market place – how do you see that developing?

Martocci: I think that fragmented can be a negative term. I see it more like independence. As compared to the securities lending market in Europe where regulations are more broad-based, the regulations that govern many of the countries in Asia are specific to each market. We will continue to see that, especially in the current regulatory environment, and rightfully so. Obviously people want to have a say over what is going on and have an overall awareness. **SLT**

David Martocci
Managing director, global head of sales and client management, securities finance
Citi

Asia

The only general conclusion one can draw about securities lending markets in Asia is that they present tremendous opportunity

ANNA REITMAN REPORTS

Because it is a huge continent of a wide variety of markets in various stages of development under the protection of numerous regulators with individual sovereign interests, Asia is a tough region to generalise about. But where there is growth, there are investors sharpening the focus to see details, and it is likely that it will be emerging markets where watchful eyes keep tabs on securities lending market developments.

The macro picture for developed markets shows weakness. Asian markets continued to drift lower in the fourth quarter of 2011 on the back of the European sovereign debt crisis and the impact of a slowing global economy on China's growth as well as the pull back in commodities and resources, according to a recent report from RBC.

RBC adds that sectors such as the consumer discretionary, banking and real estate continued to attract lending demand though borrowers are using internal inventory to cover shorts resulting in substantially reduced demand from traditional lenders.

The hot spot for revenue growth is Hong Kong, where average income from securities lending increased 50 per cent in the last three months of 2011, from 16 bps to 22 bps, according to Data Explorers. This, it adds, was down to rerating since the demand to borrow was fairly constant through the quarter.

"The big question is for how long this juicy lending environment will last. With news of China's trade surplus reducing, some commentators think a stimulus could be around the corner. There is nothing like a centrally planned boost to the economy to set fright to short sellers betting on the China slowdown," says Data Explorers.

Wayne Burlingham, global head of securities lending at HSBC Securities Services, identifies Hong Kong as the most exciting developed market in Asia currently, where he has seen revenues pick up across the board in a mostly specials environment of consistent demand. Meanwhile the regulatory environment is still conducive to international players, he adds. Given that economic conditions remain the same, he anticipates that the island will continue to be a good place for securities lending business.

"The whole of Asia is an exciting region for HSBC. If you look at the number of potential lending markets in the east versus the west, for example Malaysia, Philippines and beyond that Vietnam and Indonesia, from an agent lending point of view there is a lot of justification in keeping a close eye on Asia versus Europe and the US. It is a region of great potential basically," he notes.

He adds, however, that the real growth sectors for securities lending markets generally, such as collateral transformation trades, do not apply to Asia to the same extent as they do in Europe and the US. The region is still about borrowing stock as opposed to seeking other trading opportunities.

That may be because so many of Asia's markets and exchanges are in development. Meanwhile, just as developed markets are seeing challenges to economic growth, emerging economies are exhibiting strong fundamentals. The local market ending 2011 as Asia's best performer was the Philippine Stock Exchange (PSE), with a four per cent gain. Capital raised on the PSE last year hit a peak of PHP 107.5 billion ($2.5bn) and there are indications that the exchange's leadership would like to see the market upswing get a further boost by introducing ETFs and securities lending in the second half of this year.

The market slightly ahead of the Philippines in terms of development is Malaysia's, which issued new rules recently making the environment "more lender friendly" Burlingham adds. For example, if a stock is on loan, it can be sold without being considered a short sale. He predicts that regulators and market participants will continue to work through other barriers to open up the Malaysian market.

China v India

As the two powerhouse economies in Asia, mainland China and India are subject to their fair share of speculation on when and how securities lending markets will open up or improve. There is plenty of work to be done in both, but whereas India has an established market, mainland China is yet to allow entry to international participants.

Commentators have noted that though mainland China has had forward momentum over the last couple of years, when any initiatives are announced in the public domain, markets take a dive. From the point of view of Chinese regulators, it is a daunting task to expose markets to these kinds of forces.

"If you are the regulator hitting the green button, even in quiet market conditions that is a big leap of faith. But if you can imagine going for it in the turbulent markets we have right now, when volatility is at historic levels, that is a massive call for any regulator. So for anyone to think the market can suddenly go from nothing to being wide open in a short space of time… that is just not that likely to happen," Burlingham says, adding that he does not expect to see too much development in 2012.

The same is true for India, where the market has arguably been relatively slow to develop. Rules that are in place are not particularly friendly to lenders or borrowers, explains Burlingham, and he would need to see further rule changes to feel comfortable. Moreover, he does not see borrowers actively pushing for supply.

"Until it gets to the point where everyone feels quite comfortable it will remain a very limited market...where we have to do things very differently there are risks, pure and simple. The market preference is always to have a lightly regulated market with professional participants in it. We are happy to work to a reasonable set of rules, but Indian regulations are very tight comparatively. At the same time, it may be that India is happy to have a domestic market without international participation. Each country has its own ways of doing things and these choices may suit their market right now," Burlingham says.

Fixed income space

At the same time, advocacy group ASIFMA (Asia Securities Industry & Financial Markets Association) is watching developments closely in the Indian repo markets. Almost all of the repo market is overnight, which contributes to an absence of liquidity in the underlying markets, notes Nicholas de Boursac, CEO of ASIFMA. In addition, there is still some progress yet to be made on issues such as title transfer and eliminating short selling restrictions.

A working group is currently preparing to make recommendations for measures to improve second market liquidity. A report is anticipated by the end of the first quarter this year.

"I think it is going to become more and more broadly accepted within Indian government circles that they need more foreign financing for the expansion of their economy and infrastructures, and therefore I expect, because government debt is going to carry on growing, that there will be changes in regulations which will make investing in India's government securities more attractive as they face that economic reality," de Boursac says.

At the moment, ASIFMA is focused on the fixed income markets in India, China and Korea. Similar to India, China still needs to make progress towards what de Boursac calls "a classic repo market", in other words, one where there is proper transfer of title, documentation, tax and accounting treatments and liquidity. Some 85 per cent of China's domestic RMB repo market is pledge repo, while the remaining 15 per cent of title transfer repo is not suitably documented and short term. He expects to see improvement within the next two years but does not anticipate that the country will see any "major disturbance" in financial markets in 2012.

"China has taken the decision that they want to make their markets more liquid and deeper and in some ways more integrated with the global markets, so that is a debate that is settled. I do anticipate some changes, but 2012 is a difficult year. There is a political transition underway and typically some of the reform agenda gets delayed so as not to get in the way of the political process. But I suspect once this transition is over, we will have some rapid progress in terms of modernising the financial system," de Boursac says.

Of all the markets straddling the emerging/developed classification fence, Korea is noteworthy for both its repo development and recent hardline stance on short selling restrictions. In terms of the won repo market, ASIFMA points to continued growth - outstanding volumes have quadrupled to some $20 trillion won ($17.8 billion) in the last three or four years. Outside of Japan, Korea has one of the most developed fixed income markets in Asia.

The country is also going through a leadership change with elections this year. Along with a change in government, there is some anticipation that short selling restrictions introduced in the summer when markets plunged could be reversed.

"Most technicians will tell you that short selling is good for markets and works for market liquidity, but you will find that those regulations are put in place for political reasons. I suspect that if there is a change in government there is a possibility that they will reverse those rules, but of course there are no guarantees," de Boursac says.

Regulatory arbitrage?

Both Wayne Burlingham and Nicholas de Boursac note that the global regulation conversation has far more to do with the west than the east. Burlingham explains that many of the European and US regulations such as Dodd Frank or Basel III affect western holders of Asian assets to a greater extent.

De Boursac takes issue with comments, which infer that Asian banks will compete for business by engaging in regulatory arbitrage. He points out that the loan to deposit ratio in Asian banks is far more favourable and dependency on wholesale funding is considerably lower than in European institutions at the moment.

"Can you treat Asia as a group? You can in certain areas, such as the fact that most sizeable Asian banks will probably be Basel III compliant before European banks…but if you look at sophistication, these markets are not fully developed in many cases and that is the challenge – to get markets to develop rather than regulate them," de Boursac says.

Asian securities lending panel debate

As the cream of the securities lending industry gather for the PASLA conference in Taiwan, we ask some of the region's experts about the prospects for Asia

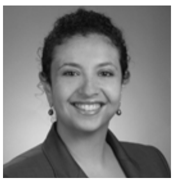
Ben Wilkie, editor

David Raccat
Head of global markets, market & financing Services
BNP Paribas Securities Services

Simon Tomlinson
Head of international equity trading
BNY Mellon

Christian Rossler
Senior vice president, global securities financing, sales Asia Pacific
Clearstream Banking

Andrew McCardle
Head of EquiLend Asia
EquiLend



Giselle Awad
Senior vice president, eSecLending Asia Pacific
eSecLending

Kirit Bhatia
Head of technical sales, Asia ex-Japan
J.P. Morgan Worldwide Securities Services

Sunil Daswani
Head of international client relations for securities lending
Northern Trust

Yin Yin Ng
Head of securities lending desk
Phillip Securities Pte Ltd (Singapore)

Francesco Squillacioti
Senior managing director regional business director, APAC Securities Finance
State Street

"Hope to see you in Taiwan"

Justin Lawson
Publisher
Securities Lending Times

SLT: How well has the Asian market recovered from the downturn?

Christian Rossler: When it comes to the financial turmoil over the last three years, the Asian markets have certainly suffered less than others and have generally coped adequately with the crisis. The lessons learnt by the Asian markets from the 1997 regional crisis – that is, development of local bond markets with increased government borrowing in local currency allied with long maturities and the generally prudent approach taken with regard to structured credit products and asset-backed securities - have helped Asian investors and markets cope with global fluctuations.

Asian banks are currently under less pressure than Western banks because of their relatively strong capital positions. And while Europe and the US are about to face a wave of regulation, which is designed to strengthen capital and liquidity requirements, Asia faces change for a different reason: the main goal for Asian market development is to ensure that the anticipated growth of Asian economies is based on a secure and stable foundation. It makes sense to ensure this growing sector is built on a well-regulated base right from the early days as it is more painful to undergo change when industry practices are more established.

The international financial crisis had the effect of detracting attention away from classical interbank triparty securities lending transactions in the region while market participants were forced to make a review of basic principles. Our experience is that we see it's the international players in Asia who are still the early adopters.

Sunil Daswani: Regulatory intervention has not, on the whole been favourable to recovery, specifically in markets such as Australia, where a short selling rule proved a disincentive to investment, and South Korea, where a ban on covered short selling hampered demand for three months in late 2011.

Borrowers have been compelled to adopt a more cost sensitive approach to their businesses, which has internalised a lot of demand. Coupled with this trend, corporate deal activity remains subdued, particularly in markets such as Japan which was negatively impacted in early 2011. Having said this, pockets of demand continue to exist in Asia and are likely to remain a priority for borrowers in the near future.

In the emerging market space, Taiwan continues to attract significant interest, given strong hedge fund demand, high spreads and compelling revenue prospects. Hong Kong also emerged as a key market particularly during 2011, where concerns over a slowing Chinese economy drove directional demand for sectors exposed to this trend.

David Raccat: The Asian market had not only the general market downturn to recover from, but also the short sale bans, short term reductions in asset allocations to some emerging markets in the region from US and European investors, and higher than usual withdrawals from local funds by Asian investors as they switched to other asset classes such as cash.

Raccat: Hong Kong has emerged to be the main driver in the region in the last calendar year. As expected, Taiwan was second. South Korea has dropped away

That said, these dynamics were not unique to Asia but as we all know Asia comprises several markets each of which has a unique dynamic and has evolved in a unique way since the downturn.

From the borrower, or demand, perspective Hong Kong has emerged to be the main driver in the region in the last calendar year. As expected, Taiwan was second. South Korea has dropped away and the most recent reinstatement of the short sale ban has not helped. Japan has continued to be Japan – stable, volume driven and nothing unexpected.

From the lender, or supply perspective securities lending has returned to the agenda across Asia. Speaking for BNP Paribas our lending supply levels are higher than pre-GFC, and we have both a strong pipeline of new clients and are being asked for securities lending services across the region. Some of the latter is exploratory – those who have not lent their securities before are comfortable that the sector is growing, is an acceptable market activity for institutional investors and want to know what levels of revenue could be generated from their assets. There is a huge amount of pressure in the pension sector at the moment in regards to performance and when discussing performance funds also review their operating costs. This is the traditional segue for a securities lending discussion and it is occurring across Asia today for us.

What is unique to the Asian region, and why it is the fast growing region for securities lending activity globally is that there is still 'new' opportunity – new lending supply, new markets or easing of access to existing markets and an active corporate sector to drive intrinsic value opportunities.

Yin Yin Ng: We have been seeing near term positives for the equities markets. The rate of contractions in Asia have somewhat eased. Major markets seemed to be recovering. In general, most of our individual traders are shunning the market for shorts and going on long for now. This could mean a temporarily quiet securities lending market for us. On the positive side, the price recovery will mean a better level for shorting in time to come.

Andrew McCardle: The impact of the downturn has taken longer to reach Asia in some respects and is still being felt. We have seen interest within the region grow as people look to automated solutions for workflows that have been very manual for a number of years. There are many local markets within Asia where our clients would like EquiLend to assist in automating services that we provide today, and as has been the case historically. These automated solutions bring efficiency and help to grow business between counterparts.

Francesco Squillacioti: In our experience, it has not been a case of homogeneous recovery: some markets have recovered more quickly than others. That said, there have been improvements overall and we feel generally optimistic about how Asian markets will perform.

Simon Tomlinson: The Asian market as a whole has weathered the downturn surprisingly well. Japan's economy has recovered better than most people would have thought possible after the devastating earthquake in the early part of 2011 and with 50 or so IPOs planned for 2012 that compares favourably to the 31 we saw in 2011. Hong Kong continues to be a significant revenue generator with good short interest and healthy spreads with property, construction and retail companies in demand. Has it fully recovered? The answer is clearly no but the headwinds and negative sentiment that are being faced in Europe and the US from both a regulatory and public perspective are not as prominent in Asia. We predict the growth to continue, aided by the continued expansion of lending inventory in Taiwan and new markets such as Malaysia and Indonesia.

Kirit Bhatia: Asia has made a strong return to lending over the past two years. Since 2009, the lendable value of equities and on-loan balances have more than doubled. Taiwan, Thailand and South Korea have been some of the stand out markets in that recovery with some of the highest percentage returns on lendable assets. On the fixed income side, Asian government bonds grew tenfold with around US$30 billion of Asian government bonds on loan – which represents just under three per cent of global bonds on loan. Clearly there is scope for growth there when you compare the region with the more mature US and European bond markets. Barring any major market shocks, we expect the positive momentum to continue into 2012 supported by a still growing macro level environment and increasingly sophisticated regional capital market.

Giselle Awad: Compared to the US and Europe, Asia is relatively bullish. Most of the major economies are experiencing growth but higher inflation in the region has the potential to trigger government currency intervention or tighter monetary policy which could temper economic growth. Specifically, China's shadow banking credit situation has worsened coupled with increasing GDP to debt ratios and inflation means a loosening of monetary policy is unlikely. While there are expectations that Chinese domestic demand will continue to grow, reducing the region's dependence on the global consumer, the reality is that Asia is still part of and influenced by the global economy and does not operate in a bubble therefore they are susceptible and have been impacted by issues arising from Europe or US

SLT: As the annual PASLA conference hits Taiwan, what is it about this specific market that makes it the most popular in Asia?

Squillacioti: Taiwan is among the popular markets in Asia. I think this is a combination of a few factors. On the one hand as the mix of activity in the market make Taiwanese securities attractive and sought-after by our counterparties. From our perspective, it's been a good market for our clients from a revenue standpoint while operating quite efficiently. And, more generally, it is encouraging that the exchange has been engaging with the market. There continues to be strong participation by the hedge fund community in this market for various strategies, and demand for these main drivers remains robust and we see no reason for a slowdown at the moment. We see these trends continuing and that should continue to keep Taiwan a popular market.

> Awad: China's shadow banking credit situation has worsened coupled with increasing GDP to debt ratios and inflation means a loosening of monetary policy is unlikely

Tomlinson: Taiwan is a market that is still under-supplied from an offshore lender's perspective so spreads remain high and returns for clients that are willing to work with their lending agents are significant. Onshore lenders' stock tends to be callable for AGM/EGMs and also for dividends so lacks the stability borrowers are looking for to maintain long term shorts. However, Taiwan is not just about shorting, It also has a very active convertible bond market which generates arbitrage opportunities along with demand to borrow for the creation of ETFs. Clearly as more lenders are able to navigate past the issues in this market and begin to participate, returns will start to come down but that appears to be some way off yet.

Bhatia: As noted above, Taiwan has been a key growth market for securities lending in the region, with market value of lendable assets growing almost 500 per cent since 2009. It has a deep and liquid market, robust capital infrastructure and sophisticated market participants. And whilst Taiwan equities only makes up a small 0.3 per cent percentage of global lendable equities, the returns are many times higher compared to more mature equity markets. Over time, this will level out, but for now Taiwan remains a key market.

> Daswani: Taiwan's popularity stems from the compelling revenue prospects that exist in the market

Awad: Demand outweighs supply for Taiwanese assets. The recent attention on short sellers while the market index underperformed has helped fuel lending opportunities in the market as onshore lenders were less inclined to participate. Even with these hurdles there is a robust on-shore lending community with short selling allowed by local and foreign institutions. While it is still a developing securities lending market, it is accessible. Lenders of offshore supply are eager to engage, but are deliberate in their due diligence of the intricacies of lending in this market. Currently, there is minimal offshore supply therefore bringing that supply to market to meet the demand can generate attractive returns for participants. Demand is focused on exports with technology, media and telecom stocks being the most attractive sectors.

Rossler: Taiwan (amongst others) has an established presence and has been relatively active in securities lending markets for a number of years. Taiwan is a centralised securities lending market which is, by nature, more transparent and more liquid than an over-the-counter (OTC) lending market. From a domestic securities lending perspective, the ability to use USD as cash collateral as well as the Taiwanese Dollar for securities lending operations since August 2010 is a sign of the importance given by local authorities to the development of this market. Taiwan also enjoys utilisation rates for securities available for domestic securities lending programmes that are significantly above average for the region and which compare favourably on a global level.

Daswani: Taiwan's popularity stems from the compelling revenue prospects that exist in the market, supplemented by two main factors. Firstly, demand remains robust from hedge funds driven largely by directional trading interests particularly in the technology and solar sectors. There is also strong demand for ADR and GDR arbitrage. Secondly, there is an obvious shortage of supply in Taiwan as many lenders attempt to navigate the operational nuances hindering their entry. These two factors have sustained high spreads for lenders and borrowers and will continue to do so in the near future.

Raccat: Taiwan is at the top end of the list but it is not without its challenges and risks! There are considerable regulations to consider in the market, namely per-stock limits on what can be short sold, which can prevent shorts being executed; tick limits when shorting, again reduce the ability to short sell in the market. Both of these regulations are a consideration when borrowing. Demand is still high in Taiwan for long/short trading strategies in technology names, and convertible bonds arbitrage/hedging. The current high demand for names is not met by the current supply in the market, so Taiwan continues to be a focus for lenders and custodians to take advantage of this upside potential for their underlying funds.

McCardle: The simple answer would be revenue potential.

SLT: How important is China going to be to the securities lending market in the region?

Daswani: China is undoubtedly an extremely large and valuable untapped source of revenue for the industry, although there is no certainty as to when regulations will allow for offshore participants to facilitate securities lending.

However, recent progress has taken place in the development of the onshore model. Following the launch of a pilot programme for securities lending and margin trading with selected onshore brokers, China adopted these as standard programmes in November last year including the enlargement of the target securities scope from 90 stocks to 278 stocks and seven exchange traded funds.

In addition, the Securities Association of China revised two rules for margin trading and securities lending, allowing securities companies to apply for both margin trading and securities lending licenses. It is also common for most Chinese clients with foreign securities to participate in securities lending programmes.

Ng: As China is beginning to open up its capital markets and may have become the second largest economy in the world, we will see even greater level of investments into China. This will mean greater need for hedging in hope of reducing equity market exposures. As such, the opening up of securities lending for China market will be important.

Rossler: Given its size and continued influence – both economically and geopolitically - in the region, China will remain firmly in the spotlight. China is an important economic driver for this region and beyond; the growth and development of the offshore renminbi (CNY) will contribute significantly to this.

Raccat: Very important – but as with many activities evolving in China its importance will be dictated by the regulatory environment and manner in which any change of regulation is introduced.

The development to date has been impressive, but still has its challenges. In under two years it has allowed activity to flow but the parameters restrict the ability of offshore entities to freely borrow and lend. For example all activity must be undertaken via a state-authorised securities finance company as agent, and it excludes qualified foreign institutional investors many of whom are licensed to trade locally through the exchanges – but cannot borrow or lend securities directly with other investors as occurs internationally. China is clearly going to be a key market for the region, and the regulators are understandably taking a measured approach whilst they review the best way to open the market up for additional activity and foreign investors.

> Rossler: Given its size and continued influence – both economically and geopolitically - in the region, China will remain firmly in the spotlight.

McCardle: China is a market that the world is watching on a number of different levels and this is no different for any firm involved in securities lending. An initial trial of a securities lending business in China was deemed a success. It moved to a live status with the opening of the market at more Chinese firms. If they can pass

the regulatory hurdles, it shows that this market is starting to move forward. A number of Chinese firms are looking to open international securities lending desks outside of China. This market will continue to grow and become of even greater interest to global securities lending firms over the coming year. However, the Chinese market allowing foreign firms to participate independently of any Chinese collaboration in a fully open market remains to be seen.

Squillacioti: It is very difficult to know when an offshore market will be in place, we are keeping an eye on developments in China

Squillacioti: There is quite a lot of interest in this topic, and judging from this and from proxy activity in H Shares, it is reasonable to assume that there will be substantial interest when the market is developed and open. Though it is very difficult to know when an offshore market will be in place, we are keeping an eye on developments in China, and look to prepare for this development as much as possible.

Bhatia: There is no doubt that China is going to one day play a central role within the context of a regional securities lending programme. Traditionally a major supplier of US and European fixed income securities for securities lending, the 2008 financial crisis did spark a pullback, with Chinese lenders suspending their participation in programmes.

However, as the world's financial markets and the global economic recovery stabilise in tandem, we are seeing Chinese lenders re-entering the securities lending market. One of the important drivers of this move back onto the playing field, is the ongoing development of China's Qualified Domestic Institutional Investor (QDII) scheme, which will be a strong source for equities liquidity as QDII participants increasingly look to securities lending programmes.

Domestically, China is also making strong progress in integrating securities lending practices into the broader financial markets. The recent announcement that it is planning to establish a centralised securities lending exchange is a positive indication of things to come, though we are watching the markets for more news on the exact timing.

Tomlinson: As one of the BRIC countries China of course will become increasingly important, however it remains restricted to onshore lenders/borrowers with no sign of that changing in the near term. As it stands right now and from BNY Mellon's perspective the other BRIC countries such as Brazil via the CBLC or Russia are either already open to a form of securities lending or working on solutions and offer more immediate opportunities.

Awad: We have seen the influence of China in the performance of markets such as Hong Kong and Taiwan where strong growth has led to robust lending markets. China will have an important indirect impact (and in the longer term a potential direct impact) on lending as they move towards more transparent and open stock markets. As a stand alone lending market, China has significant potential however foreign participation in securities borrowing and lending is still far off as lending is currently only conducted by local participants onshore under a pilot programme. China is taking steps towards a more robust securities lending market. In 2010 it started a government run pilot programme involving 25 brokers and covering 90 eligible stocks. In 2011 the list of eligible stocks was expanded to 278 and seven ETFs, however the 25 brokers are only able to lend securities from their own funds and holdings are not significant.

SLT: What impact is the new global regulatory environment having on the market in Asia?

Bhatia: As the world's regulatory environment continues to evolve, we're remaining focused on delivering value to our clients, who are in turn focusing on market fundamentals in terms of executing their strategic growth plans. As you can see from the figures we have shared previously, the significant growth in securities lending across Asia is a clear indication that the market continues to move in the face of regulatory flux. Regulatory change, the anticipation of regulatory change and the need to adapt as and when things evolve has become almost business as usual – a constant that needs to built into regular practices. That is not going to change in the foreseeable future.

Awad: Regulation varies from one country to the next and it is important to understand the nuances of each. Asian markets have histori-

cally imposed specific securities lending rules aimed at greater transparency. Regulators are generally supportive of the practice and often work with the industry to create solutions. They have the advantage of already having established securities lending policies and can wait and see what/how US/European regulators change theirs and then consider applying where appropriate.

Bhatia: The significant growth in securities lending across Asia is a clear indication that the market continues to move in the face of regulatory flux

Rossler: Basel II implementation is still 'in progress' in Asia; some countries have implemented new regulations, for example, Hong Kong, while others such as China are still in the course of implementation.

Asian countries seem generally supportive of Basel III implementation although many have not made public commitments. However China, Japan and Singapore have all confirmed in one way or another that they support Basel III.

Financial institutions across the globe are facing the additional burdens of increased collateral management as required under the G20 decisions taken in Pittsburgh in 2009. But research commissioned by Clearstream from Accenture revealed that many banks are paying a high price for inefficient collateral management within their institutions. Accenture studied a number of international banks and found that some 10 to 15 per cent of available collateral is often left unused because it cannot be consolidated. The cost of fragmented collateral was estimated by Accenture at more than USD 5.27 billion a year – but this estimate reflects the current situation; the Basel III measures can only increase this figure.

The main problem identified in the report was that internal structure in global banking operations has now become very complex and so prevents many institutions from having a single view of their available collateral. All of the institutions which took part in the in-depth study reported having inadequate collateral management systems which is why some institutions and infrastructures are now looking to insource this function.

Daswani: The impact of these regulations remains largely undefined currently since details of how they will be implemented are yet to be finalised

Daswani: The importance of the global regulatory environment will remain a prominent securities lending theme this year, with the roll-out anticipated of rules stemming from regulations such as Dodd-Frank, Basel III, and global short selling rules. However, the impact of these regulations remains largely undefined currently since details of how they will be implemented are yet to be finalised in most cases.

Northern Trust's securities lending experts are active participants in the discussions being had by industry associations with regulators around the world, allowing us to provide valuable input to the various agencies responsible for drafting these new regulations. Our involvement also puts us at the forefront of regulatory and market changes with our ability to influence and drive positive change ultimately benefitting our clients.

Regulation in Asia for securities lending has been restrictive in some cases and onerous in others and continues to be at the forefront of conversation, particularly regarding emerging markets.

Short selling rules imposed in 2011 constrained demand and although lifted in South Korea for non-financials in November 2011, these continue to be a threat amidst market volatility given the difficulties in hedging against it.

Short selling reporting regimes such as those in Australia (and soon-to-be in Hong Kong), whilst onerous on market participants, have not emerged as disincentives to invest and the consensus is that such transparency is beneficial, provided the information is accurate and protective of entity disclosure. There has not been any specific impact ahead of the roll-out of Basel III although it is perhaps premature to speculate at this stage.

Raccat: As the majority of the working groups and discussions are being chaired in London and Hong Kong these may assist in standardising the approach across some markets in Asia.

That said, we have the impression that the local regulators across Asia feel that they have appropriate levels of regulation in place and this was evidenced by the robustness of Asian markets during the global financial crisis, so we may have some recommendations adopted but not others, as regulators continue to adopt 'best practice' but avoid any potentially negative impacts to their markets.

> Tomlinson: Asia seems to be watching with interest as to how the western markets implement the new rules and the effect they will have on their markets

McCardle: At present it does not seem fully clear as to how the ongoing discussions of regulatory or even legal changes that may come into effect this year will impact the global markets, including Asia. Regulatory changes are something that have been a concern for many clients over the past years in Asia - but regulators in different countries have decided to take different tacks to try to insulate their economies from many of the perceived downsides - to a thriving securities lending market.

Squillacioti: This is another area that many will be keeping an eye on in the coming months. For the most part, regulatory reform has been relatively positive in the Asian markets. As with the question of market improvement above, from a regulatory standpoint as well, it's not really a homogeneous market and it's to be expected that you would see differing developments in the various markets. Asia has a mix of both developed securities lending markets and developing securities lending markets. There are some markets that have been established for a few years making continual tweaks and improvements. There are markets that are just beginning to explore implementing securities lending, such as China and other markets that are reviewing changes to existing models to make them accessible to offshore participants. Market structures such as in Taiwan offer regulators and the exchange a high degree of inherent transparency into the market. This probably serves as a way to mitigate the need for the imposition of many other regulations that are seen in other markets. Hong Kong is a good example of a market that has been an extremely favourable one from a regulatory standpoint over the past several years, and we believe serves as a model for other markets in the region. All in all, directionally, the various markets and regulators' approach to securities lending seems relatively positive.

Tomlinson: Asia has always had various forms of market dependant regulation such as Hong Kong with the pre hold requirement (SLHK), which allowed it to perform favourably during the height of the credit crisis and avoid having to enact any short selling bans. With the global changes taking place, Asia seems to be watching with interest as to how the western markets implement the new rules and the effect they will have on their markets. Obviously the introduction of Basel III with its new capital, liquidity and leverage requirements will affect financial institutions everywhere and we expect to see a continuation of the theme we are seeing in the US and Europe to move towards equities and other types of securities as collateral and term up business where possible.

SLT: What emerging markets are making significant moves forward in terms of SBL?

Rossler: Asia is one of the key growth regions in the global securities lending market and, currently, Asian equities markets represent a significant share of the total equities that are on loan. The utilisation rate is also higher on Asian equities than the rest of the equities markets. In terms of securities lending fees, some of the highest fees are paid on Asian equities leading to greater revenues for this activity.

In Asia, local currency bond markets are underdeveloped compared to their domestic equity markets. However, there are signs that this situation is beginning to change and many Asian countries are making significant strides in developing their bond markets. As I mentioned earlier, the fact that local currency bond markets have deepened significantly since the 1997 regional crisis, means that emerging Asian markets have been able to deal more effectively with the international crisis this time around. Therefore, we would also expect local bond markets across Asia to continue to develop and issuance in domestic currencies to increase, with a greater depth of domestic investment.

Daswani: Apart from Taiwan maintaining its position as the priority emerging market for most lenders in the region, recent changes in Malaysia are likely to make it easier for offshore participants to engage in this market.

Contrary to an initial ruling, regulation was passed in January 2012 to allow for lenders to recall loaned securities after selling those securities under a securities lending transaction, subject to various conditions. This is a significant step forward and participants are expected to pursue actively lending in Malaysia, albeit that uncertainty exists around revenue prospects at this stage.

Raccat: China, which if you combine the market capitalisation of the Shanghai and Shenzhen Exchanges together are roughly the same size as the London Stock Exchange. However we also continue to watch India, which is still a synthetic market, and would like to see some material developments given the growth of this local exchange which is now the 12th biggest exchange (by market capitalisation) globally.

McCardle: In Asia the emerging markets that are of keen interest seem to be India and China.

Squillacioti: Malaysia enhancing its offshore model is certainly evidence of making strides as an 'emerging' market for securities lending. It presents some exciting opportunities. We also continue to look at markets such as Indonesia's offshore market, the Philippines, and Vietnam, which also currently seems to be exploring the potential of SBL.

Malaysia looks to be the next market that BNY Mellon will be focusing on although Indonesia also seems to be making progress. We should not forget India, which although it is currently very restrictive, is definitely one we have our eye on should the dialogue that is being had with the SEBI lead to any material developments.

> Rossler: The utilisation rate is also higher on Asian equities than the rest of the equities markets

Bhatia: In short, China. As noted above, China is making strides in developing their domestic securities lending platform and we expect it to be an important market in years to come.

Awad: Taiwan: When securities lending was first introduced it was limited to on-shore participants, however the regulatory authorities moved to open lending to offshore lenders. This benefited the Taiwanese marketplace by injecting a new source of liquidity.

South Korea: Korea's ban on short selling during the later part of 2011 hindered activity in the market. Following the lift in Nov 2011, demand has returned particularly for exclusive supply.

Malaysia: Since 2007, Malaysia allowed lending through a Bursa Clearing, acting as a central lending agency. Since 2009 it has also allowed SBL NT (securities lending and borrowing negotiated transaction) model where it provides approved participants the ability to agree to SBL transactions on an over-the-counter basis and then report such transactions to Bursa Malaysia via on-shore representatives.

India: The regulatory regime has significant barriers to entry but some rules have started to relax eg, loans are now allowed for one year increased from seven days.

SLT: Is the subject of CCPs causing much debate in Asia? What are your views?

Raccat: We field lots of questions regarding CCPs from our lending clients and the key questions are 'Will these add value in terms of transparency' and 'Will these reduce risk as with CCP proposals for other activity types such as OTC Derivatives'?

Ng: The CCP model at a multiple assets / derivatives level is definitely offering greater operational efficiency as well as central counterparty risk. However, it has always been a debate of whether CCP increases or reduces counterparty risk. We have seen that even the 'best' of financial institutions can fail. As such, the question in mind would be who is in the best position to take on the role as a CCP to ensure the elimination of such counterparty risk.

Rossler: The introduction of a CCP forces a re-assessment of the role of the agent lender in interfacing between the lender and the borrower. This sounds like bad news for agent lenders but Clearstream believes its CCP will bolster rather than undermine its relationship with lenders and borrowers. The advantages of a CCP to securities lending are clear and the lenders gain the additional reassurance of the trades being intermediated by a CCP on top of the protection already afforded to them by the collateral advanced and the haircuts levied.

McCardle: The topics of CCP seems to have been a heavily debated one for many years now and in some Asian markets has been a reality for some time. It does not seem to be a topic as widely discussed as in Europe over the past two years.

In speaking to the EquiLend client base throughout Asia and the Pacific, it seems that for those markets where there is a CCP in place it works but there is no desire or requests for those models to be replicated in the other Asian markets.

When looking at the number of firms seeking to launch or run a CCP globally, there are no large projects to provide a route to markets via a CCP where it is not mandated. In Europe and America we have seen a number of CCPs being established or looking to launch recently but none seem to have taken off as predicted two years ago, highlighted by the recent closure of SecFinex in Europe.

Ng: it has always been a debate of whether CCP increases or reduces counterparty risk. We have seen that even the 'best' of financial institutions can fail

Squillacioti: From our perspective, it has not caused that much debate in Asia as yet. Our view continues to be that the various markets will approach securities lending in a way that fits into their overall regulatory context, and in a way that allows for the development and expansion of a lending market, which is consistent with their level of comfort. We continue to advocate, either directly or through industry bodies, such as PASLA that to the extent possible within these parameters markets are allowed to operate as openly as possible so as to allow for and foster significant participation.

Tomlinson: At BNY Mellon we are open minded with regards to CCPs and their place within securities lending. As it stands right now we are yet to see a viable model and if we talk specifically about Asia, there is less discussion underway, with no real push to go down this route. In an age where costs are under the spotlight and risk reward is a major focus for our clients absorbing the additional costs that would likely come from using a CCP does not seem to be currently justifiable.

McCardle: we have seen a number of CCPs being established or looking to launch recently but none seem to have taken off

Bhatia: As with regulation, I think the debate, at least for CCPs for derivatives is over. We see many countries making strides towards the implementation of CCPs, particularly for derivatives trading. There is analysis which suggests these moves will generate large demand for high grade collateral to post to CCPs and securities lending could be one way for institutions to generate the collateral. It's an interesting space and could be a positive force for generating lending demand.

Awad: Many Asian countries (Malaysia, Taiwan, Korea, India) require securities lending transactions to take place through a CCP so it is not a new concept in the region.

SLT: What are the key trends you expect to see in the coming year?

Tomlinson: Companies looking to raise capital is a definite. As I indicated before there are as many as 50 IPOs likely to take place in Japan alone for 2012, the highest since pre credit crisis and the outlook for M&A is cautiously optimistic although there are concerns that the global economic weakness may have an impact. On the hedge fund side it is widely believed that inflows will be higher in 2012 as pension funds and retail investors look to increase their allocations. If we are focusing in purely on securities lending borrowers will continue to seek to push costs down and look to go further down the collateral curve. Equity collateral should continue to become more prevalent and it will be key for lenders to have a solid suite of collateral options on offer whilst maintaining a strong stance on risk management.

Bhatia: China moving towards an active securities lending market will be a theme. Regulatory flux will also be a constant but one that the market will absorb as an ever present reality. At a macro level, economic turbulence, particularly in Europe will continue to cast a shadow and could throw up unexpected market disruptions. Overall though, we expect the return to lending return to continue in 2012 with greater focus on the core value of the lending transaction and risk management.

Awad: We expect the industry evolution to continue, with beneficial owners placing increased focus on multiple providers, benchmarking and performance attribution. While the current regulatory landscape has negatively impacted demand, we believe that as greater clarity is obtained and finalised, activity should increase. We anticipate increased demand from borrowers around SCRIP/DRP related opportunities within Asia as well as Japanese dividend trades as participants seek out additional revenue opportunities. Emerging markets will continue to be a focus for the industry as they have growing economies, a large base of assets to invest, multiple constituents, good liquidity, and passively held investments.

Rossler: Regulatory pressure and new liquidity guidelines are forcing counterparties to collateralise transactions to an even greater degree than before. Effective collateral mobilisation underpins all critical liquidity management but many institutions do not have systems that can cope with the complexity of today's banking architecture. This has prompted a growing interest in white-labelled solutions and franchising arrangements in collateral management. For example, since July 2011 Clearstream has launched such a solution in Brazil by providing collateral management to the local CSD, Cetip, which allows Cetip's customers to comply with local legislation as their underlying assets remain in Brazil. Additionally, since August 2011, Clearstream has entered into exclusive talks about collateral management cooperation for Australia. This new product enables customers – central banks and infrastructures - to optimise the use of collateral, that is making sure the correct quality of collateral is allocated at the right place and at the right moment with maximum efficiency.

> Awad: we believe that as greater clarity is obtained and finalised, activity should increase

The new regulations are changing the landscape globally and Clearstream is fortunate to be well-placed as our collateral management and securities lending expertise is becoming increasingly well-known in Asia. This region is a very important growth area for us and we are continuing to focus heavily on the evolving needs of our Asian clients. We anticipate that Asia will make an increasing contribution to our revenue stream from its current level of approximately 20 per cent.

It is likely that the demand for cross-border transactions will increase in Asia in line with other markets around the world. This is why we have extended our settlement processing window to cover the Asia-Pacific business day so that our customers can now access collateral management services around the clock. Triparty collateral management services are available to our customers 21/24 hours a day and are supported by our operations in the region. The trend for more globalised markets means customers need global solutions.

Daswani: Our expectation is that markets will remain volatile while global macro events continue to dominate the headlines and as such, prevailing uncertainty is likely to constrain borrower demand as hedge funds remain cautious and risk averse.

Furthermore, an expectation exists that borrowers will continue to prioritise the efficient use of their balance sheets which will lead to a desire for greater collateral flexibility from lenders, as well as a continued theme of inventory internalisation where possible. Lenders will continue to maintain an aggressive stance on rerates given the lower levels of general collateral available and weaker reinvestment earnings. Lenders will also continue to actively pursue new markets to tap new revenue streams, particularly those that are emerging.

Raccat: For borrowers, collateral – what is pledged, how it is pledged, substitution and ease of settlement, reporting & transparency. Collateral flexibility seems to be becoming more and more of a discussion topic across the market. As desks strive to both focus on margins every basis point has become important as borrowers strive to maximise their in-house – if any – inventory.

For lenders, transparency, risk management and performance equals comfort. Lenders are more aware of their securities lending activity today and as lenders realise the potential revenue, risk mitigations and how to monitor their lending activity, the true dynamics and role of short selling in the markets - we expect more and more beneficial owners to become comfortable with securities lending and some of the 'discomfort' around the topic is disappearing. **SLT**

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The business program will include discussions on

- Informational Short Selling and Institutional Framework Round Table
- Taiwan Securities Borrowing and Lending Market Update and Forum
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- 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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Beneath the surface

There's more to securities lending than meets the eye, says SunGard's David Lewis

MARKET PERSPECTIVE

If there is one subject that permeates every securities lending forum, it is the need to educate every stakeholder who takes an interest or even participates in our part of the wider financial markets. Misinformation and incorrect assumptions make it all too easy to portray securities lending as a "shadow banking" bogeyman stalking the honest, downtrodden investor.

As an agent lender at the time of the Lehman default, I myself experienced the sharp end of such negative sentiment, from being physically and metaphorically poked in the chest to being introduced to a pension fund's investment committee, by its own chairman, as a "robber and a thief"!

A great deal of this anti-lending feeling has come from the linkage many have made between securities lending and short selling. But securities lending is not the same as short interest. In fact, it does the industry a disservice by ignoring the other significant reasons that borrowers borrow and lenders lend. It does no good for the markets either, because it risks overstating negative sentiment.

It cannot be disputed, of course, that short selling is a significant driver of borrowing and contributes to the balances we see out on loan. But that is only a part of the story. Other motivations to borrow include:

- Market making, which accounts for a significant portion of the overall market activity – without lending and borrowing, brokers could not access the kind of liquidity required to keep spreads down and the market functioning with increased settlement certainty
- Fails management – borrowing to cover for when things do go wrong
- Financing – the lending of assets against cash to reduce funding costs to enhance a funds returns
- Yield enhancement – transitions of share ownership for tax efficiency
- Collateral management –an increasingly important part of the market demand profile

On most exchanges, there is no requirement for borrowers to provide a reason for their decision to borrow a security. As a result, there is no systematic way to accurately determine how much of any loan balances are attributable to what purpose. Moreover, distilling short interest from the securities lending data will vary from security to security. For example, it is relatively easy to correlate short interest and securities lending for a volatile share in an oil exploration company which does not typically pay dividends and is unlikely to show up on an acceptable collateral schedule. It's much more difficult to do the same for a highly liquid blue chip stock or a government bond. As such, there is no formula that can be applied to every security.

Take, for example, the indexed on-loan balances of Total SA (FR0000120271) and Dragon Oil (IE0000590798). Total is almost exclusively a dividend or yield enhancement security, whilst Dragon Oil displays the level of loan volatility that might be associated with a typically volatile share price – ie, attracting significant directional interest. The distinctive peaks of borrowing activity over the dividend dates must not be confused with short interest for Total SA (dividend record dates are 18th May, 14th September and 14th December 2011).

The increasing attention being paid to collateral management is also confusing the analysis of demand and supply. It is said that there will be an increase in demand for "quality collateral" as banks need to fund paper at a time when high quality collateral is getting scarce. These trades cannot easily be separated as a borrowing motivation, but clearly rising securities lending does not equate to rising short interest. Organisations may be lending large quantities of general collateral (GC) stock against cash and then placing that cash back with the same borrower in a repo transaction against lower quality corporate bonds and other non-cash assets. Termed Repo for GC or Ratio Trade, the repo tends to be at a lower value than the underlying GC loan.

For European funds, yield enhancement makes up a very significant proportion of the annual returns in their lending programmes; some say as much as 70 per cent of the year's revenues are compressed into the all-important European Dividend Season. Whilst this is not an activity that some wish to publicise for fear of raising the ire of regulators, popular press or even clients, it is not the social pariah of short selling. The graph below shows the clear contrast between the European markets, which are predominantly dividend season driven (note the April and May peaks in borrowing costs), and the relatively consistent activity levels both in Asia and the US.

The misinformation about securities lending is also reflected in political activity. Greece has recently extended its ban on the short selling of certain securities on the Athens Stock Exchange, and similar bans remain in place in France, Italy, Spain and Belgium. *[Editor's note: this article was written before the bans were lifted]*

Yet the academic evidence continues to build against such bans. Research shows that they actually harm the very investors that the regulators are trying to protect. A 2009 Federal Bank of New York paper indicated that the drop in liquidity during a 14-day ban in short selling of some 995 US securities widened spreads in the equity and options market and added around $1bn in costs. Short selling bans drove away lenders and effectively removed the oil which lubricates the market. Widening spreads are a result of the friction introduced by the loss of liquidity created by securities lending.

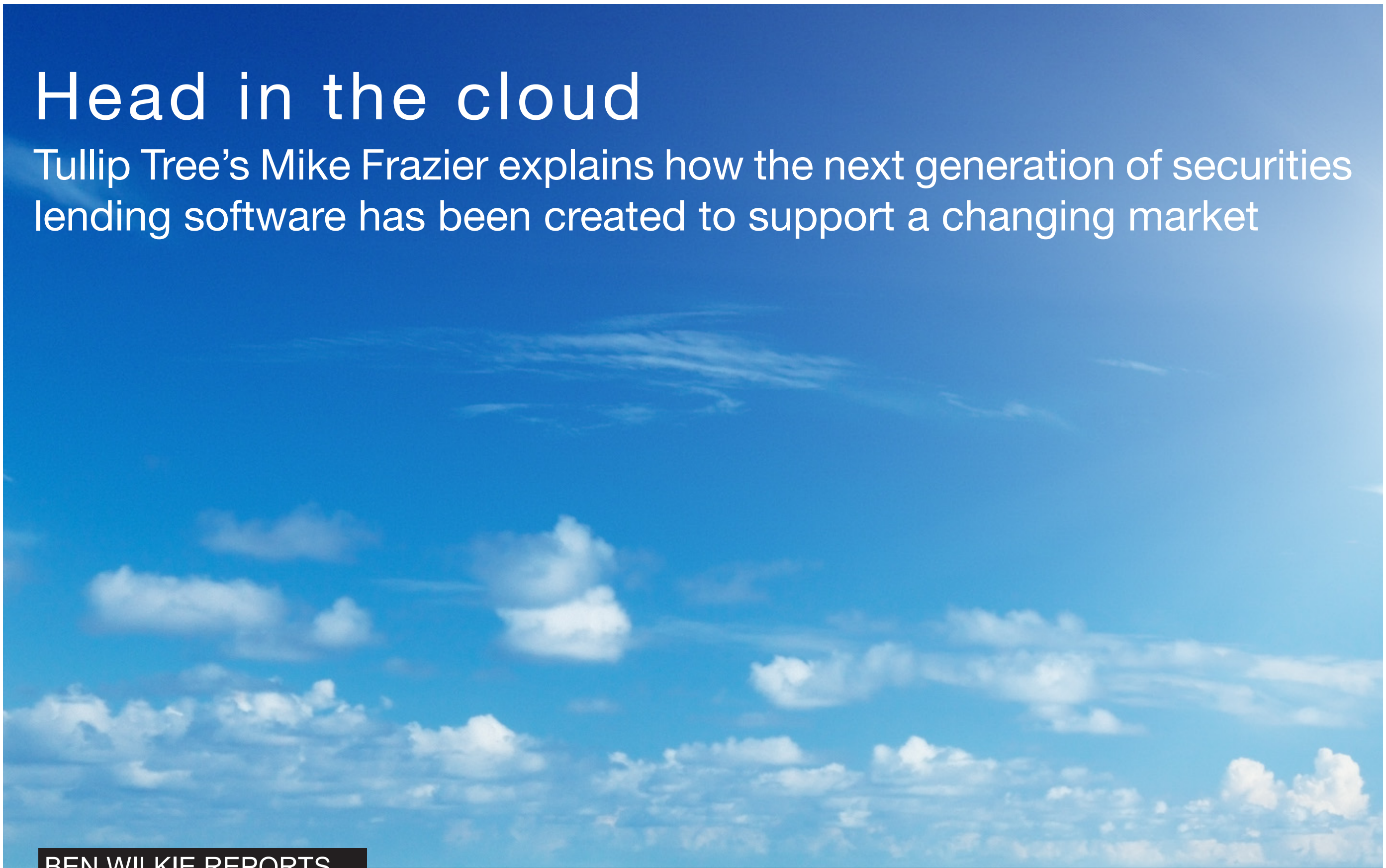
Even before the Fed paper was published, then-chairman of the SEC Christopher Cox described the ban as a regret: "I believe on balance the commission would not do it again... The costs appear to outweigh the benefits".

It is incumbent on the liquidity providers to help regulators understand the benefits that securities lending brings to the market and its investors as well as the diversity of reasons to engage in this activity. Breaking the assumption that securities lending balances are the same as short interest is a vital step, but it's only one on a long road to bringing securities lending out of the shadows. **SLT**

David Lewis
Senior vice president
SunGard Astec Analytics

Head in the cloud

Tullip Tree's Mike Frazier explains how the next generation of securities lending software has been created to support a changing market



BEN WILKIE REPORTS

SLT: How do you see the securities lending market at this time?

Mike Frazier: At this time, the market has consolidated, there is far more globalisation in the industry. An increased risk awareness has made investors wary and investments have declined. But with that said, we're hopeful that we have reached a stable level in the markets where we see an upward progression.

There has been a lot of uncertainty in the markets over the past couple of years, which means the industry will grow more slowly than it has in the past and will have fewer participants - it remains to be seen if those who have left will return.

I think the growth will follow improvements in the eurozone and other major markets. Eventually, rates will start to come back up, they can't stay where they are forever! Investors have been on the sidelines for so long. But fundamentally, things have changed.

SLT: What is the reasoning behind the launch of the new business in the current climate?

Frazier: The current climate is forcing some companies to rethink and retool their business model and there is a need to meet the needs of those companies.

SLT: What can Tullip Tree bring to the securities lending market that will differentiate the firm from competitors?

Frazier: We have a competitive pricing advantage through the economies of scale from the cloud computing platform.

We provide multiple solutions with enhanced functionality that are suitable for each individual client. With our products, it doesn't matter if you're a big or small firm, you can still compete in this market. The service allows smaller firms to take advantage of the software available to larger firms, software that was previously at a price point unfavorable for them - they can now go out into the market and compete.

Lastly, the product offering is global in nature.

SLT: With all the technological changes in the industry, is it easier for a new operation to offer a high quality service to customers, rather than an established business that has to change many of its legacy systems and practices?

Frazier: This is a tough question and there's not a straightforward answer. Firms that have never really focused on their technology in the past are at a disadvantage, because you have to have the right technology to be competitive. So if your firm has consistently developed its technology, it will be able to compete at the same level as newer operations.

Budgeting for technology costs is difficult for any organisation, which is why we have decided to offer a modular system that can be phased in. And because it's cloud based, it reduces the costs. And when you take an established business that has legacy systems and practices, you can't change it overnight. But you can take a phased approach and move away from the legacy systems one by one.

SLT: How about the regulatory side? How much is regulation changing the industry?

Frazier: The regulatory changes in the industry are requiring companies to adapt much quicker than in the past to meet the needs of the market conditions. Technology is essential for companies to make the necessary changes needed in a timely manner on the regulatory side.

SLT: You're operating on a cloud-based platform. What advantages does this bring?

Frazier: First advantage is the up-front reduction in capital expenses that companies have

endured in the past from buying dedicated hardware and software.

Second advantage is the time to market; with our solutions it is simply creating a dedicated environment for your company in the cloud. For example, with the global inventory management module, we create the environment for the client and connect their inventory feeds through an API. The client can then start using the module to document locates that will in turn produce reports for compliance and management.

Another advantage with cloud computing you are able to free up valuable IT resources from maintaining hardware and software directly related to the product. These IT resources can now concentrate on higher priorities within the company - an example of an indirect cost savings that impact the bottom line.

SLT: Are there any security concerns?

Frazier: Security is a key factor of ours, it always has been and it always will be. Over the last five years, though, security within cloud computing has developed so that it now simulates the security features that users have come accustomed to within their company's LANs and WANs.

SLT: Can you tell me a little about the securities lending team you have at Tullip Tree?

Frazier: We have a pretty talented group with years of experience in the financial industry focusing on operations, execution, trading and technology. I've worked in the industry for over 12 years, on the operation and technology sides of the house.

SLT: Where do you expect your clients to come from? Are your team bringing them along from their previous roles, are you getting firms that haven't historically dabbled in securities lending, or are you getting experienced clients who are confident about running their business relatively independently?

Frazier: This product can be used by both smaller and more established firms and we're marketing to all participants in the industry. However, it does depend on the overall market. If we had a sudden upturn in the market, firms might be less likely to change and keep with the status quo. But in the current climate, firms are looking for efficiency and looking to improve their processes for when the market does turn around.

SLT: How do you see the next 12-18 months developing?

Frazier: No question, we're experiencing uncertainty within the securities lending market. Low levels will remain until the euro markets sort themselves out and rates rebound. We'll see some companies looking to invest in the future by cutting costs and positioning themselves for growth.

For us, we're going to concentrate on the securities lending industry and provide customers with alternative solutions to meet their needs. **SLT**

Mike Frazier
Managing partner
Tullip Tree Advisors

Industry appointments

Kirtes Bharti, director, equities and prime services at Credit Suisse, has left the bank according to sources.

Bharti, who is also chairman of the PASLA Executive Committee is rumoured to be moving to a hedge fund. Credit Suisse declined to comment.

Penson's board of directors has announced the appointment of **Robert Basso** as independent director. He is also appointed as as a member of two committees - Audit and Nominating and Corporate Governance.

In other people moves, **James Dyer** has resigned from the Penson board.

HazelTree has appointed **Sandeep Rawal** as chief technology officer (CTO). He replaces Matt Johnson, who is taking on consulting duties for HazelTree at a hedge fund, which is also the company's tenth licensed client.

Rawal most recently served as CTO of Fir Tree Partners, where AUM grew to more than $7 billion during his tenure. He brings over 20 years of knowledge and experience from Moore Capital Management and Maverick Capital in New York.

Pasquale Cestaro and **Bruce Turner** have been named co-chief executive officers of Quadriserv and members of the firm's board of directors.

Quadriserv operates AQS, a central counterparty-based market that offers automated securities lending trading in over 5,000 underlying equity, ETF and ADR products.

Cestaro, a 30-year veteran of the equity finance industry, was previously Quadriserv's vice chairman. Turner, who oversaw the launch of the AQS and AQS Direct platforms, was most recently president and chief operating officer. Thomas Perna will continue as chairman.

"The combination of Pat, who brings his experience in working with the biggest players in the securities lending industry, and Bruce, who has led securities trading, technology and market structure initiatives for brokerages and exchanges for two decades, will further enhance our capabilities in meeting the needs of clients," Perna said.

"As liquidity and order flow continue to expand on the AQS platform, our model becomes increasingly compelling for the industry's major participants," Cestaro said. "I look forward to collaborating even more closely with Bruce as Quadriserv continues exploring ways to provide central counterparty-based value to new clients and enhanced services for current customers."

GlobeOp has appointed **Tim Ridley** to its Cayman Islands subsidiary board. Ridley, the former chairman of the Cayman Island Monetary Authority (CIMA) and a former senior partner of Maples and Calder, was appointed following the recent resignation of Gary Linford.

Ridley served as CIMA chairman from 2004-2008, having been a member since 2002. He is a frequent speaker and writer on financial services and regulatory themes. Ridley has also served as an editorial board member for several leading industry and legal publications. He currently serves as a director of various private companies.

"Demand for greater hedge fund transparency and governance is increasing," said Vernon Barback, GlobeOp president and COO. "Tim Ridley's legal, financial and regulatory expertise will be a benefit to GlobeOp and its clients. We look forward to his contributions as we focus on independent valuation, regulatory and board reporting. I would also like to thank Gary Linford for his contributions to GlobeOp - particularly related to Cayman regulatory updates - since his appointment to the board in 2008."

The announcement comes as private equity firm, TPG Capital, agreed to buy GlobeOp for £508 million. Though GlobeOp management has urged shareholders to approve the sale, the Financial Times reports that rival hedge fund administrator SS&C Technologies is setting the stage for a bidding battle.

Robert Chiuch has been appointed global head of equity finance at BNY Mellon, while **Rob Coxon** is no longer involved in securities lending.

Chiuch, who was previously managing director in the securities lending team, will also have responsibility for equity finance. He will report to James Slater, global head of securities lending.

Coxon was managing director and head of international securities lending at BNY Mellon, responsible for the EMEA securities lending business for the bank. He joined BNY Mellon in 1997 as a securities lending trader.

His next role has not yet been made public.

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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