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BNY Mellon launches Global Collateral Services

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BNY Mellon has formed Global Collateral Services to service institutional investors, banks and broker dealers facing rapidly expanding collateral management needs.

Global Collateral Services brings together BNY Mellon's existing broker-dealer collateral management business, securities lending, collateral financing, liquidity and derivatives services teams into one group that will focus on delivering a full range of innovative collateral management solutions.

Kurt Woetzel, senior executive vice president and the head of global operations and technology, will lead the new service.

James Slater, the global head of securities lending at BNY Mellon, said via email that regulations and changing market dynamics are mandating new and complex requirements for the use of collateral, and they are forcing sell- and buy-side firms to re-evaluate their need for and use of collateral.

He said: "By forming Global Collateral Services, BNY Mellon is meeting a market demand to simplify clients' ability to manage counterparty and market risk and maximising value for collateral transactions through segregating, optimisation, financing and transforming collateral."

Institutional investors, banks and broker dealers have reacted "very positively" to the formation of Global Collateral Services, according to Slater. "What is particularly attractive is that we are able to accelerate our on-going product development in an area where BNY Mellon already enjoys significant competitive advantage."

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SLTINBRIEF

Cries of fraud for Chinese tech company Qihoo

Qihoo has joined the list of Chinese companies accused of fraud by short sellers. The Bejing-based online security software developer has denied allegations made by Anonymous Analytics that user traffic on its website is lower than described.

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South Korea to introduce short selling report rule

Short sellers will be required to provide reports on their short positions in South Korea as of 30 August so that regulators will have more access to data on short selling activities.

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BNY Mellon launches Global Collateral Services

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BNY Mellon is well positioned to help clients in the current economic environment as one of the largest servicers and managers of financial assets globally, according to Slater.

He said: “We are the world’s largest global custodian and have one of the largest securities lending programmes with $3 trillion in lendable assets. BNY Mellon operates a proprietary global collateral management technology platform that is specifically designed to handle all asset classes denominated in any currency. This platform can process derivatives, triparty repurchase agreements, portfolio swaps, collateralised loans, and margin management activities in multiple currencies.”

Slater said that Global Collateral Services will segregate collateral in third party custody accounts providing risk mitigation to counterparty credit concerns, assist in maximising lending terms and mitigating counterparty risk, provide tools to safely and efficiently deploy collateral through optimisation, and provide services that can assist with collateral needs such as collateral financing.

Cries of fraud for Chinese tech company Qihoo

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“Qihoo’s directory page gets significantly less traffic than management has led the capital markets to believe,” said Anonymous Analytics. “All that massive traffic volume that was supposed to transform Qihoo into an Internet marvel doesn’t exist.”

Qihoo’s CFO Alex Xu denied the claims, saying the report was a repetition of what other short sellers have said in the past, and the company has clarified these sorts of claims before.

But in light of the allegations, American depositary receipts (ADRs) of the company sank to $16 in New York, the lowest price since January, in turn prompting the US SEC to put a short selling restriction in place.

Traders who want to bet on a further drop must wait after the stocks fall 10 percent from the prior day’s closing level.

Other Chinese companies accused of misstating information include, Sino-Forest, which filed for bankruptcy in March after it was accused by a short seller of misstating business and assets, and China Medical Technologies, whose trading of ADRs was suspended last week by the US SEC after questions arose about the accuracy of company information.

South Korea to introduce short selling report rule

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South Korea’s Financial Services Commission (FSC), Financial Supervisory Service (FSS) and Korea Exchange (KRX) are introducing the mandatory reporting requirement following a three-month ban on short selling that was implemented in August 2011.

In a joint statement, the FSC and the FSS said: “Short selling provides liquidity through diverse investment strategies and is an efficient price discovery mechanism. However, there were

also concerns that short selling would distort market order and be abused for unfair trading in times of unstable stock markets."

The rule will apply to an investor who has an open short position of 0.01 percent or above of the issued share capital of a KGX-listed company. Investors who meet the threshold will have three-working days to file their reports with regulators, while investors who continue to meet or exceed the threshold will have to report regulators at the end of each trading day.

The FSC and the FSS added: "The proposed rule is designed to have a better picture of the overall short selling activities and a systematic collection of data on outstanding short positions so that regulators can cope with unfair trading in a timely manner."

Investors will have to provide the name of the short-sold stock, the name and other personal information of the reporting individual, the total quantity of open short positions of the short-sold stock and the proportion of short positions to the issued share capital in a report to be filed electronically through the FSS website.

Implementation of the rule will require amendments to the Regulation on Financial Investment Services, as well as FSC approval in August.

LIBOR lie so serious

The former CEO of Barclays, Bob Diamond, has apologised to UK MPs, but denied personal culpability, for the bank's manipulation of LIBOR rates.

Diamond appeared before the UK Treasury Select Committee after he resigned from his post on 3 July in the aftermath of the LIBOR scandal, which has rocked British banking.

Financial institutions contribute rates that are used in the calculation of LIBOR and EURIBOR. The contributed rates are supposed to reflect each bank's assessment of the rates at which they can borrow unsecured interbank funds.

For LIBOR, the highest and lowest 25 percent of contributed rates are excluded from the calculation and the remaining rates are averaged to calculate the fixed rates. For EURIBOR, the highest and lowest 15 percent are excluded and the remaining 70 percent are averaged to calculate the fixed rates.

Futures, options, swaps, and other derivative financial instruments traded in OTC markets and on exchanges worldwide are settled based on LIBOR, and mortgages, credit cards, student loans and other consumer lending products often use LIBOR as a reference rate.

According to reports, between 2005 and 2007, and then occasionally through 2009, certain Barclays traders requested that the Barclays LIBOR and EURIBOR submitters contribute rates that would benefit the financial positions held by those traders.

Traders in New York and London made the requests via electronic messages, as well as telephone and face-to-face conversations. The employees responsible for the LIBOR and EURIBOR submissions accommodated those requests on numerous occasions in submitting the bank's contributions. On some occasions, Barclays's submissions affected the fixed rates.

On top of Diamond's resignation, Barclays's board has agreed to an audit of its business practices. It has paid the US Department of Justice a $160 million penalty to resolve violations. The US Commodity Futures Trading Commis-

sion (CFTC) has ordered Barclays to pay $200 million, and the UK Financial Services Authority (FSA) fined Barclays £59.5 million for misconduct, which is the largest fine ever imposed by the FSA.

But the bank's co-operation with the FSA entitles it to a 30 percent discount under the FSA's settlement discount scheme, and the Department of Justice's assistant attorney general Lanny Breuer said that the bank took a significant step towards accepting responsibility for its conduct by being the first institution to provide extensive and meaningful cooperation to the government.

Tracey McDermott, the acting director of enforcement and financial crime at the FSA, said: "Barclays' misconduct was serious, widespread and extended over a number of years. The integrity of benchmark reference rates such as LIBOR and EURIBOR is of fundamental importance to both UK and international financial markets. Firms making submissions must not use those submissions as tools to promote their own interests."

"The BBA [British Bankers' Association] is currently undertaking a review of the way LIBOR is set and will publish its findings shortly. The FSA, along with the other tripartite authorities, is working to support market-led reviews of existing arrangements, with the goal of ensuring such arrangements continue to command the confidence of all stakeholders."

Losing LIBOR

Breuer called LIBOR and EURIBOR "critically important benchmark interest rates", but some financial industry professionals have called for the most prevalent benchmark rates to be reassessed. The BBA, which has overseen LIBOR for 26 years, is working with the government and regulators to abolish rate manipulation.

In a recent blog post, Jonathan Cooper, senior consultant at securities and investment research firm Finadium, said LIBOR has major downfalls that need addressing.

He said: "For LIBOR there aren't actual trades being reported—only an estimate of where it might trade. It is a major weakness."

"LIBOR had already lost its effectiveness as a short-term benchmark. It isn't only the manipulation scandal that has done it in. During the financial crisis the market found out the hard way just how much credit risk was embedded in LIBOR. When OIS spreads were narrow, it didn't matter much. But when they blew out ... the situation changed completely. Inefficient forwards, a result of the credit risk, made LIBOR useless."

"Acknowledging that LIBOR was not an appropriate rate, broker/dealers and clearinghouses like LCH.Clearnet started discounting swaps, for mark to market purposes, using OIS curves. At least OIS is linked to the Fed Funds effective ... which is a rate that is both observable and executable, save for some basis risk between Fed Funds Open and the Effective ... Even OIS has its weaknesses. Like LIBOR it is unsecured. And the Fed Funds market is much less liquid now that the FRB pays 25bp on reserves and the FDIC includes it when calculating insurance fees. We wonder if repo on 'safe assets' wouldn't be better?"

OneChicago nets June record

Equity finance exchange OneChicago's trading volume reached 868,512 in June—a 334 percent increase on May—making it the exchange's highest monthly volume total since February 2007.

OneChicago also saw 848,441 exchange futures for physicals and blocks traded in June, which represented $4 billion in notional value.

More than 160,000 futures with a value of approximately $800 million were also taken to delivery in June.

OCC's securities lending volume rises

OCC's cleared contract volume declined 6 percent in the first half of 2012, but its securities lending volume rose 15 percent.

Its cleared contract volume reached 329,891,797 in June, which represents a 12 percent decrease from the June 2011 volume of 376,877,261 contracts. This means that OCC's year-to-date total contract volume is down 6 percent with 2,100,988,040 contracts in 2012.

OCC's stock loan programme, which includes OTC and AQS, saw 80,284 new loan transactions in June 2012. This represents a 17 percent increase on the June 2011 figure.

Year-to-date securities lending activity is up 15 percent from 2011 with 458,578 new loan transactions in 2012. OCC's stock loan programme had an average daily notional value of $31,668,868,660.

Banco de la Nación Argentina is latest Lombard client

Banco de la Nación Argentina New York (BNA NY), a branch of Banco de la Nación Argentina (BNA), has chosen Lombard Risk to meet compliance requirements.

BNA NY will be using the Lombard Risk regulatory compliance solution, integrated with Temenos' T24 core banking system, for New York, Florida and Grand Cayman regulatory reporting.

Leo Rodriguez, the vice president of BNA NY, said: "Lombard Risk's regulatory reporting solution REG-Reporter came very highly recommended to us by our core banking solution provider, Temenos, citing the team's experience of integrating their regulatory reporting solution with Temenos' T24 banking system."

John Wisbey, the CEO of Lombard Risk, commented: "We are currently working with several other major US firms that face June 2012 regulatory deadlines relating to the Dodd-Frank Act, and our existing and expanding client base, proven technology and the increased interest in automated regulatory reporting solutions in the Americas' market will continue to contribute to our growth."

Vincent Raniere, managing director and the head of regulatory in the Americas added that Lombard will also further extend its footprint into Latin America, as REG-Reporter will be used to process the bank's BCRA and Superintendencia de Bancos de Panama regulatory reports.

J.P. Morgan polishes up collateral management in Japan

J.P. Morgan Worldwide Securities Services has updated its collateral management platform in Japan.

Auto Allocation, a part of J.P. Morgan's global collateral management platform which was previously not offered in Japan, has been tailored for the market there, to be made available to Japan-domiciled counterparties who wish to use Japanese equities for collateralising repos or loans of securities or cash.

Fumihiko Yonezawa, head of Worldwide Securities Services, Japan, J.P. Morgan, said: "By further extending key functionalities from our global collateral management platform to this market, our domestic Japanese clients significantly benefit from greater automation of the entire collateral management process."

Blair Harrison, head of collateral management, Asia Pacific at J.P. Morgan Worldwide Securities Services, said: "These platform enhancements in Japan underscore our ongoing commitment to supporting our clients with innovative solutions, with a view to making the collateral management process easier, simpler and faster."

"This development showcases one of J.P. Morgan's core strengths—the ability to bring global efficiency to our clients, tailored to meet local market requirements."

J.P. Morgan Worldwide Securities Services's triparty offering for the Chicago Mercantile Exchange's (CME's) IEF4 programme recently began supporting corporate bonds as collateral.

In an email interview, Jason Orben, the Americas product executive for collateral management at J.P. Morgan Worldwide Securities Services, explained the decision to support corporate bonds.

"J.P. Morgan has supported the CME's IEF4 programme for many years, and the addition of corporate bonds as eligible collateral is a natural extension given changing regulations that place a higher emphasis on both central clearing and effective collateral management. As a leading collateral agent, supporting this added asset class was really quite straightforward. Our sophisticated global collateral system handles a full range of asset classes—equities, fixed income, corporate, government and municipal bonds, convertibles, ETFs, mortgage/asset-backed securities, gold and more—and allows counterparties to efficiently allocate and optimise their use of collateral."

He added that while it was possible that over time, the range of acceptable collateral may expand further, the immediate impact of proposed regulations will be an increased call for high-grade, highly liquid collateral.

Ratings impact on Coast collateral agreement

Fitch ratings has declared that a proposed change to the Coast Collateral Management Agreement (CMA), in which the CDO asset management responsibilities for the transaction would be assumed by Crescent Capital Group, would not affect its ratings.

Crescent is the successor collateral manager to Coast Capital Asset Management.

"The most senior class in the transaction is currently rated 'CCCsf', indicating that default appears a real possibility for the notes," said a statement from Fitch.

"In addition, the CDO is no longer in its reinvestment period and all overcollateralisation tests have been failing. Given the above, the manager's capabilities are no longer a rating factor for this transaction. Accordingly, Fitch has not evaluated the replacement manager and does not expect the novation to have any impact on the ratings of the notes."

Fitch went on to state that under the new CMA, Contingent Collateral Management Fees will be paid before interest to the class A notes, but said that the impact on the notes from a rating perspective is mitigated by the cushion available between the notes' credit enhancement level and 'CCCsf' level losses.

BlackRock reinforces securities lending limit

At the end of 2011, it was reported that BlackRock's iShares ETFs lent out on average 92 percent of the securities that they held.

Yet, in a move that will come as a disappointment to the firm, client concerns around the practice have forced them to impose a 50 percent securities lending limit for each of its ETFs.

Clients complained that, despite BlackRock's policy of returning 60 percent of the lending revenue back to the fund, a large part of the securities being loaned only offered added counterparty risks to their portfolio.

However, the firm maintains that it has the ability to lend out more, with a source close to the story predicting BlackRock will stretch the 50 percent limit if it does not see the revenues it wants.

Nigeria releases guidelines on securities lending

The Central Bank of Nigeria (CBN) has released guidelines on foreign participation in securities lending.

A letter from the bank addressed to all authorised dealers, custodians, stockbrokers and the general public detailed the processes for issuance of Certificate of Importation (CCI) for securities lending transactions.

The bank directed all authorised dealers to ensure strict compliance with the provisions of the circular.

"The foreign borrower shall be issued a CCI upon importation of capital for the purchase of collateral securities. The foreign borrower reserves the discretion to keep the cash collateral in Nigeria in foreign currency. In this situation, no CCI shall be issued for the collateral," the bank stated.

EU short selling legislation moves closer

The EU has moved a step closer to implementing the Short Selling Regulation with the European Commission's approval of a delegated act that outlines rules on the ban of uncovered sovereign credit default swaps and short sales of shares and sovereign debt.

EU institutions agreed on the regulation's text in November 2010. Its aim is to harmonise the short selling of shares and sovereign debt in the EU.

The commission and ESMA (the European Securities and Markets Authority) are working on the Level II stage of the legislative process for the Short Selling Regulation.

Level II measures will clarify how the Level I text of the regulation will work in practice. The delegated act on the ban of uncovered sovereign credit default swaps and short sales of shares and sovereign debt is a part of a package of four implementing measures that the commission has approved to specify the technical aspects of the Short Selling Regulation.

The delegated act also outlines other technical rules, including how to calculate the significant short positions that must be disclosed to regulators or the market; the levels at which short positions in sovereign debt must be notified to regulators; the decline in liquidity that triggers the possibility for EU member states to suspend restrictions on uncovered short sales of sovereign debt; and the criteria to be taken into account when determining what constitutes an adverse development or event.

The commission has also approved a delegated regulation on regulatory technical standards that sets out how to calculate the significant fall in value that can trigger a short term suspension of short selling in certain financial instruments.

The commission adopted two other regulations as part of the package of four on 29 June.

Michel Barnier, the European commissioner for the internal market and services, said: "We cannot tolerate speculation on uncovered sovereign credit default swaps. The ban on such credit default swaps is a key provision of the Short Selling Regulation, to ensure that these instruments are used for legitimate hedging purposes only. The delegated act adopted by the commission will ensure this ban is applied by market participants and enforced by regulators in a uniform way."

The Short Selling Regulation and its implementing measures are expected to enter into force in November.

Euroclear's highway to collateral

Euroclear has devised what it terms a 'Collateral Highway', which it hopes will create the first fully open global market infrastructure to source and mobilise collateral across borders.

It aims to help market participants move securities from wherever they are held to serve as collateral for access to central bank liquidity, secured transactions such as repos and securities loans, and margins for CCPs and bi-laterally cleared OTC derivative trades.

The 'Collateral Highway' will have multiple collateral entry and exit points. The entry points are where collateral will be sourced from all Euroclear central securities depositories (CSDs), agent banks, clearers and CSDs that are located in any time zone. The CMU unit of the Hong Kong Monetary Authority and BNP Paribas Securities Services have been the first to join.

MXCorner

Preparing for opportunities

The sheer volume of regulatory change that is on its way suggests that participation in securities lending is going to become more complex and costly. At the same time, lower levels of leverage in the system may mean that hedge fund demand for flow business will remain subdued and that dividend arbitrage may reduce, as tax regimes harmonise (although it feels like that's been said for years!). So, where can lenders look for new revenue opportunities?

It's a dilemma and one many lenders should be grappling with. After all, funds still need to show good performance and the risk return ratio and/or ROCE of securities lending should be compelling relative to other investment strategies, if presented correctly. It is in times when performance is hard fought for that funds should be considering increased lending activity, and this is best achieved by considering lending activity in the context of the broader portfolio strategy and risk profile. A more proactive approach is needed, with lenders actively identifying and pursuing opportunities.

The age-old solution is to look to new markets where returns can be significant, and if you have a large enough emerging markets portfolio, this may still be the right option. However, it is surprising how quickly new markets become old markets and rates fall accordingly, so unless you have a significant portfolio in a particular market, consideration needs to be given to, not just the headline rates, but their durability to ensure that they will produce reasonable profits once you have considered the reputational risks and costs of entering (and remaining in) these markets. While there may be big profits to be made for early entrants with access to large supplies, just opening up in another new market to increase returns always seems a bit tactical to me.

Opportunities within existing programmes are often event driven or structured around funding requirements, and establishing the right strategy for maximising them for each individual fund beforehand is critical. In order to get the engagement that is needed from a lender, agents must be able to provide detailed information about the activity to be undertaken and potential opportnities in a format and risk language that the lender can easily understand and interpret.

This is achieved by understanding the fund's objectives, dynamics and risk measurements. Being able to present innovative structures (or even minor tweaks to existing programmes) within the context of the broader portfolio strategy in risk adjusted language that the lender is familiar with, so that it can compare them to other investment strategies, is key. Building confidence and understanding in this way helps the agent to maximise opportunities efficiently when they arise.

MX Consulting Services can help to develop strategies and client reporting solutions to help lending business stay in front.

Sarah Nicholson, senior partner
MX Consulting Services

Optimum prime: rise of the BRIC prime broker

SLT talks to Gregory Wagner about his new job at Brazilian bank Itaú BBA and how he plans to build the first global prime business for any Brazil bank from the ground up

MARK DUGDALE REPORTS

Why did you join Itaú BBA?

I have never been a part of an investment bank that dominated its home market as much as Itaú BBA does. The bank is number one across the board in almost every category, including investment banking, equities and fixed income in Brazil, and it is in the top tier of the wider LatAm market. It is an advantage that we are intending to leverage.

Also, Itaú BBA is large and well capitalised—it is the largest bank in the southern hemisphere and a part of the Brazil economy, which is the sixth largest economy in the world. When you put these together and add its commitment to internationalising its business with products such as securities finance and prime finance, it was a no brainer decision to join Itaú BBA.

Furthermore, I guess that I get cruel pleasure from going through the pain of building a business and watching it grow from the ground up. I have built two of these platforms already and this is my third. When you build from the ground up like this, and you do not have to unbundle anything, you always have the opportunity to use the best technology, business principals and governance to deliver a cutting edge product. This is especially true in wake of the ever changing, new regulatory environment and investor concerns about counterparty risk concentration. There is nothing to unbundle and re-build here. We are looking at a white sheet of paper, envisioning three years ahead, thinking about how the business should look and are building from there.

The most important part for me was not missing out on helping a bank to take advantage of its growing prominence in what is probably the most dramatic shift in global investment banking in a generation. The markets are always moving to more efficiency and a more even playing field. In the current environment, a more even distribution of global investment bank market share and revenues are inevitable. I am certain that Itaú BBA will be a part of the growth in this trend.

What do you hope to achieve?

Itaú BBA has a strong presence in the securities lending market in Brazil. We will look to leverage this so that we can internationalise the business, to provide local clients with more global product solutions, and bring more international clients into the local Brazil and LatAm remit where possible. Once we get that right, we will look into developing more esoteric international products for our clientele, particularly market access, as well as synthetic and physical prime offerings further down the road.

When does a bank such as Itaú BBA fit into the prime brokerage market?

Medium and larger hedge funds are always trying to balance the optimal mix of prime/swap providers on their roster so that they can obtain operational efficiency and minimise their prime brokerage counterparty risk. If a hedge fund has too many prime brokers, it can be a challenge to manage the operation. Too few prime brokers could lead to investors knocking on the hedge fund's door with pitchforks and torches complaining about undue counterparty risk.

With the 'black cloud' discussions in Europe and the 'banks that are too big to manage' debate in the US, on top of the upcoming higher capital requirements of new regulations, hedge funds and asset managers are actively seeking new outlets to diversify their risk. So, when we talk about the optimal mix of providers, the pendulum has likely swung to choosing more primes/swap providers rather than less.

Given its hub locale, Itaú BBA is a great hedge to these trends. We will not be everything to everybody, as our main focus will always remain on Brazil and pan-LatAm products, but we will look after those clients that execute through our equity and fixed income local market capabilities with a world class, global, 'post- trade' solution.

How much demand is there from hedge funds for securities lending?

Although volumes are down everywhere, securities lending performance is still a decisive factor to a hedge fund when it is choosing a prime brokerage provider.

Stable securities lending supply is critical to a hedge fund, because they are still the largest shorter of assets than any other organisation. It is no secret that prime brokers are harshly judged by the stability of their lending supply to the funds. Inconsistent or disrupted short supply means disrupted trading strategies to the fund, which could put prime brokers in 'the penalty box'.

While favourite hedge fund strategies involving shorting equity, such as convertible bond arbitrage, have been down consistently since 2009, equity long/short strategies are expected to remain a growing and major strategy of hedge funds over the next few years. Prime brokers will continue to refine and develop competitive securities lending/collateral transformation offerings as a result.

What regulations are of most concern to hedge funds and how are they affecting their appetite for securities lending?

The hedge fund clients that I have spoken to over the past year are becoming increasingly concerned with capital related regulatory changes such as Basel III and how they will affect their providers' abilities to maintain committed balances to them. When this is macro-regulatory directive is overlaid with the very region-specific regulatory requirements that we are witnessing in Europe and somewhat in the US, there is a possibility that a 'regulatory imbalance' could be created that is defined by these regional centricities. Depending on the severity of the imbalance per location, it could force certain prime/swap providers to completely re-assess the balance sheet that they deploy to this business.

The last thing that a hedge fund wants to hear from a prime broker is that its balance sheet allocation is going away. At best, it is operationally intensive to move assets around on short notice, and at worst, it disrupts hedge funds' trading strategies. This is why they are very focused on the matter.

Since Itaú BBA is looking to deploy only new capital or balance sheet to the prime business, we are in a different situation. We will carefully account for the upcoming and long-term regulatory requirements affecting Credit Risk RWAs and ROE, and only then will we deploy allocations. This way, we are less likely to have to reverse course and surprise our clients with bad news.

What types of clients are you targeting?

Firstly, we must build a securities finance platform to take care of Itaú BBA itself. We need to industrialise our ability to monetise any and all assets at the bank. I have to make sure that we are able to turn assets into cash to optimise reliance on wholesale unsecured funding. Internally, I need to be the customer of this bank first.

Secondly, we will cater to existing clients at Itaú BBA, which already includes some of the larger asset managers, corporates and institutions. There are plenty of clients doing business at Itaú BBA. We want to develop more products to offer to them, and our prime mandate will be designed to fill some of that gap.

What types of products do you want to offer?

We are focusing on developing the more vanilla flow products first, including securities lending, repo, collateral management and collateral transformation. As we are able to better leverage Itaú BBA's already strong geographical footprint, we will be adding products into the UK and Europe, and then into Asia and the Middle East. This will be led by a market access platform to give our clients the ability to not only access Brazil underliers in different ways, but other emerging, and frontier markets that are important to our clients. We then plan to offer a more industrialised synthetic prime platform, and if required down the road, a physical offering.

However, I think that the trend towards a physical relationship with providers, at least from the large hedge fund perspective, is reducing. Most of the largest hedge funds have their own custody accounts and they will allow a prime broker to clear for them or finance for them, but they will not let a prime broker do both, because of the counterparty risk issue. We'll take these into consideration and perhaps partner with a custodian in that space. **SLT**

Gregory Wagner
Global head of prime services
Itaú BBA

Stable securities lending supply is critical to a hedge fund, because they are still the largest shorter of assets than any other organisation. It is no secret that prime brokers are harshly judged by the stability of their lending supply to the funds

Get SBL to the Greek

Securities lending in Greece has taken a hit thanks to regulatory and economic uncertainty, as SLT finds out

MARK DUGDALE REPORTS

The risk of recession in 2012, particularly in the eurozone, has forced governments to return to the drawing board again and again as they try to appease voters without damaging delicate and complicated financial markets. As governments try to understand financial practices such as securities lending—their advantages and disadvantages—rules that are aimed at strengthening financial systems and practices are being introduced and periodically reviewed.

In Greece, an "extraordinarily complex trading environment" has emerged, according to David Lewis, senior vice president at Astec Analytics, a SunGard capital markets business. He says that a combination of short selling bans, bailouts, repeated elections and the threat of a referendum on eurozone membership have led to the current trading environment.

Lewis adds: "Whilst the market has been open for securities lending for some years, the volatile nature of the economy has diminished its attractiveness."

Short selling is one area of securities lending that has attracted significant interest from regulators and governments. Greece's Hellenic Capital Market Commission (HCMC) implemented a ban on the covered and naked short selling of shares that are listed in the Athens Exchange in August 2011. HCMC planned to lift the ban in October, but then decided to extend it to December after talks with ESMA (the European Securities and Markets Authority) and the supervisory authorities of countries such as Italy and Spain, which also limited or prohibited short selling at the same time as Greece. After unsatisfactory conditions in the Greek capital market, HCMC extended the ban once again—this time to 25 July 2012.

In a statement that was released in August 2011, ESMA said: "[S]ome authorities have decided to impose or extend existing short-selling bans in their respective countries. They have done so either to restrict the benefits that can be achieved from spreading false rumours or to achieve a regulatory level playing field, given the close inter-linkage between some EU markets. These measures have been aligned as far as possible in the absence of a common EU legal framework in the area of short-selling and given the very different national legal bases on which such measures can be taken."

Whether the aim of Greece's short selling bans is to restrict the benefits of spreading false rumours or to achieve a level regulatory playing field, they have had a significant effect on securities lending in the country.

Lewis says: "Securities lending is a characteristic of an efficient market and lending should certainly be encouraged in any market to support market settlements as well as efficient price discovery. Greece is facing a multitude of structural issues at present and, even though all mature markets show that the mechanisms of securities lending and short selling positively affect their markets, political pressures in the Greek markets may well discourage active promotion of these facilities."

Market makers and breakers

Short selling bans have affected borrowers' demand for securities lending in Greece. "Demand is not huge; short selling bans have kept some investors at bay," says Lewis. "But other risks and concerns have also kept others out. Individual securities continue to attract some interest when issues arise, such as the maturity dates of certain government bonds in the light of default fears."

The fear of default is another factor that borrowers are considering when looking at their trading strategies in Greece. Lewis says: "Issuer risk is a greater concern for investors with the risk of default or an exit from the euro making trading economics complex to say the least."

"Short sellers would factor such possibilities into their position taking, but there has not been a great deal of activity on this front as investors seek other opportunities."

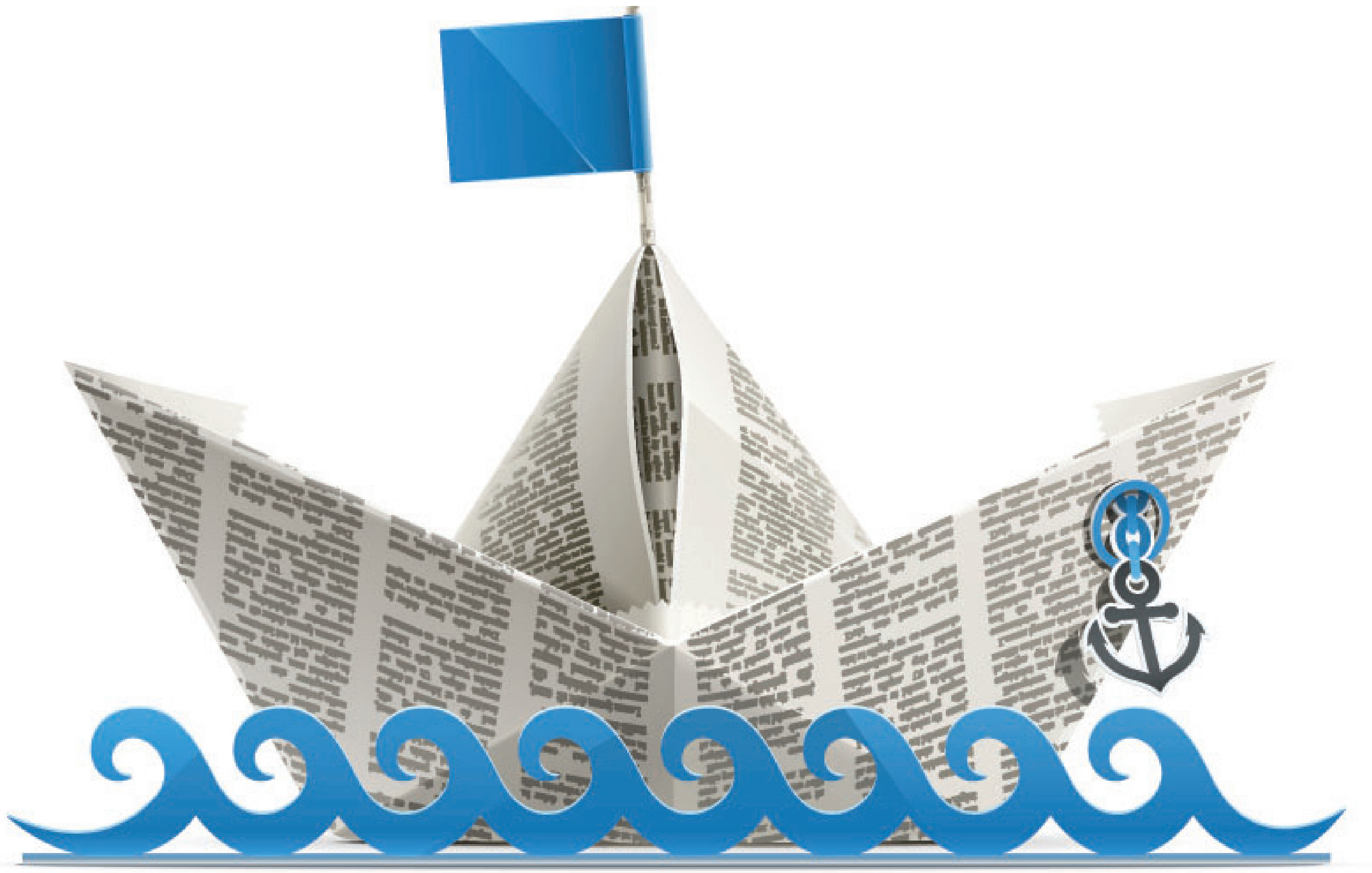
Issuer risk is a greater concern to borrowers than lenders, says Lewis. "As a lender, the beneficial owner will make their own investment decisions regarding the issuer risk of the securities they hold in their portfolios outside of any lending decisions they may make with regards to participation."

"Borrowers look keenly at the issuer risk of the securities they borrow and along with that, closely monitor the value of the collateral that they provide to the lender. As a borrower is effectively downgrading their collateral, they will be monitoring the risk that collateral is exposed to very carefully."

As a result of the political and economic difficulties that the country is facing, Greek securities have also "fallen out of favour with investors", adds Lewis. "As a result there has been a drop off in the available supply of some securities being held in lending funds."

Although short selling bans are in place and borrowers are concerned about issuer risk, securities lending business is being done in Greece. Citi's securities finance business began offering agency lending services in the country in February 2010. In a statement released at the time, Citi said that adding Greece to its lending network would open up the country to "new sources of liquidity and support the development of ... local capital markets". Citi declined a request to comment.

Lewis concludes: "Securities lending brings a positive impact to the liquidity of any market; without it spreads widen and costs for investors rise. Economic concerns and regulatory uncertainty have unfortunately affected the level of lending activity in Greece and as a result the market will have suffered, and will continue to do so." **SLT**



The economics of the Plimsoll Line

David Lewis of Sungard's Astec Analytics examines shorting interest in the giants of the marine sector

MARINE DATA

For those of you without any nautical knowledge, the Plimsoll Line (invented by one Samuel Plimsoll in the 1870s) indicates the safe load limit of a cargo ship. It is used extensively today to ensure that ships are not overloaded and that their cargoes and crew are more secure than they were back in the 1800s.

In the same way that the Plimsoll Line can show how heavily loaded each ship is, the demand levels in the shipping industry can be a good indicator of trade activity between nations. Prosperity and expanding global trade mean ever larger ships are plying the oceans, rushing goods and raw materials from producer to consumer. However, a faltering global economy means fewer ships are needed and more are laid up—something I remember from my youth, sailing around the rusting dormant hulks in Falmouth, Cornwall in Southwest England. Reputedly the third largest natural harbour in the world and, importantly, the deepest in Western Europe, Falmouth is a popular area for storing massive ships while they wait for economies to pick up.

As with many similar markets, there are traded rates for shipping. One of the best known is the Baltic Dry Index (BDI), which is the market rate at which dry commodities (rice, coal, etc) would be shipped around the world. Prior to the Lehman Brothers default, markets were bullish and optimism was high, and the BDI was around 11,000. However, the BDI began to fall as ship owners, acting as look-outs, you might say, cut rates in the face of falling demand. The first quarter of 2012 saw the BDI at around 1,000—its lowest for 25 years. Is this the sign of even worse trade data to come?

Perhaps it is, but what does it mean for the shipping sector? The marine sector includes some giant companies, such as China Ship Container Lines (CLSC, 2866.HK), which has significant short interest building up in their shares.

The on loan balance for CLSC has increased significantly over the last 12 months, as Figure 1 shows. Although there was a small recovery in the share price in the first quarter of this year, the shares have sunk around HK$0.81, or around one-third over the last 12 months. The on loan balance, being a good proxy in this case for short interest, increased a further 8 percent in the last month. So there is a clear sentiment that the price has further to fall.

Overall, the on loan balances for the marine sector have increased 8.74 percent in the last month to over almost 1.3 billion shares in all; a portion of those companies are based in Greece, adding further pressure to the beleaguered economy. Greece is famous for its shipping lines and the billionaire families that control them and looking at Athens-based Dryships (DRYS), which owns a fleet of 61 dry bulk carriers and oil tankers totalling over 7 million tons, shows that the suffering in Greece extends into the shipping industry.

Opening a year ago at $4.19, it is now trading at $2.19, and despite a falling short interest until January this year, the on loan balance has come back to around 20 million shares.

Japan is also a major maritime nation whose economy has also suffered as part of the global slowdown. One of the larger ship builders and shipping lines in Japan, Kawasaki Kisen (9107.HK), faces the same issues as Dryships and CSCL: falling global demands and a glut of shipping capacity. Kawasaki's share price has fallen around 13 percent, but again, the sentiment indicates that many feel it has further to fall.

Prior to the current financial crisis, booming markets demanded extra capacity and significant orders were placed for new and bigger ships. Now that these ships have been built, they are not needed and form a significant flotilla of overcapacity. Figure 3 shows an increasing on loan balance over the last 12 months, while the rebate rate becomes increasingly negative.

Few would argue that the financial markets lack data. The key is finding that piece of actionable information that can reliably indicate the future direction for global trade and national economies. Increasing loan balances, outside of yield enhancement periods, are an excellent indicator of investor sentiment towards a given security or industry. When the performance of an industry is so closely correlated with the physical delivery of raw materials, commodities and finished goods to their buyers, you have a formidable array of data to work with.

The small selection of companies selected for this analysis show a disturbingly negative trend with regards to market sentiment. Arguably, this view holds more sway when you consider that each of these shipping companies has a blend of long and short-term contracted rates. Some long-term leases, struck during better times, will come to an end. They may not be renewed, or they may be renewed at today's much lower rates. The third option is conversion to short-term lease rates that demonstrate greater volatility but provide the possibility of taking advantage of the next upturn—if and when it comes. Of course, looking at the variety of data and market signals aiming to measure overcapacity in global shipping, one way to read the market is to take a sailboat down the Helford River in Cornwall and look up at the silent ships waiting there. **SLT**

Figure 1: China Ship Container Lines (2866.HK)

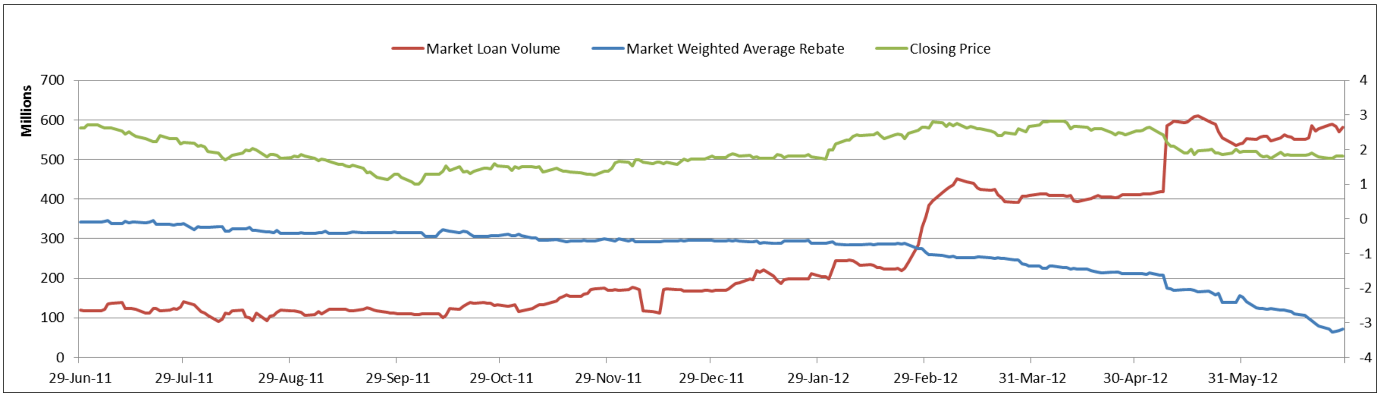


Figure 2: Dryships Inc. (DRYS)

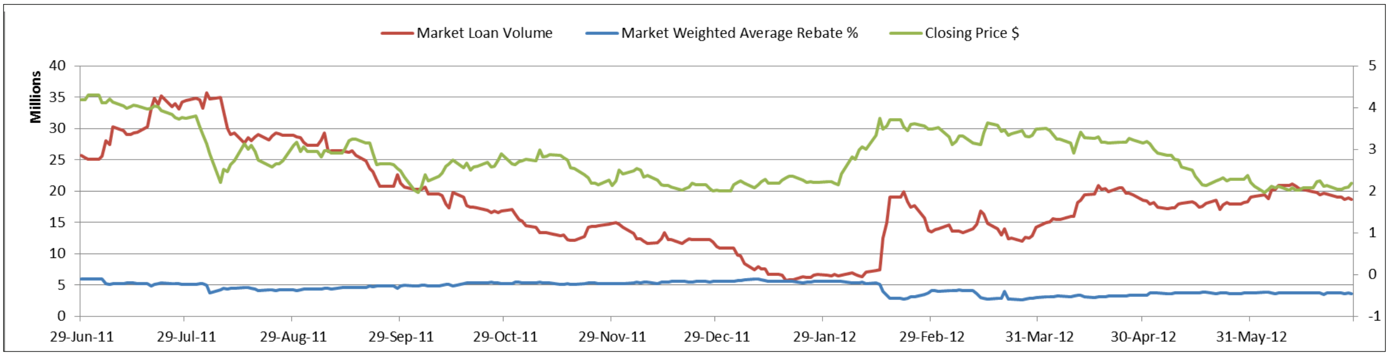
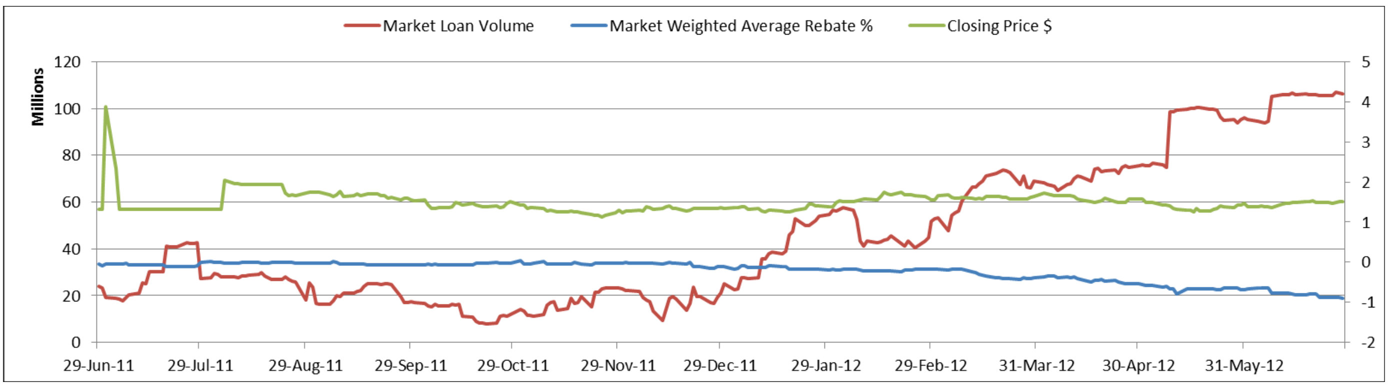


Figure 3: Kawasaki Kisen (9107.HK)



2012

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Over the past few years, the financial markets and new regulations have changed the way businesses manage their collateral.

2nd Annual Collateral Management Asia

Location: Singapore
Date: 15 - 16 October 2012
www.collateralmanagementasia.com

As the financial world looks to improve transparency and reducing risk, collateral management is becoming an increasingly regulated entity. Custodians and clients alike scramble to align their business affairs with the new regulatory requirements

Industry appointments

HSBC Securities Services has hired ex-Deutsche Bank prime broker **Paul Busby**. Busby's role will be to head up prime services sales for the Americas. He will be reporting locally to Tom O'Leary, head of Americas equities, and functionally to Chris Barrow, global head of prime services.

Piers Murray will be Deutsche Bank's global head of fixed income prime brokerage in markets clearing.

Reporting to Jon Hitchon, the head of markets clearing, Murray will begin in Deutsche Bank's New York offices in September.

Prior to this appointment, he was the global head of rates clearing at J.P. Morgan.

David Gray will be the new head of prime services and client execution for Asia Pacific at the Royal Bank of Scotland.

His appointment to this role, which has been specifically created, will involve building on the integrated prime services business in the Asia Pacific region.

The team will include futures and options, prime brokerage, central counterparty clearing and a newly created mandate sales team.

Prior to joining RBS, Gray worked for UBS for 17 years, taking on the role as head of prime services for UBS in Australia in 2001.

Citi has made **Richard Street** the EMEA head of client sales management for investors.

Street joined Citi in 1993 and has managed its securities and fund services franchise across the Middle East and Pakistan. He has been based in Dubai since September 2007.

In his new role, Street is responsible for Citi's investor client sales management teams across EMEA. He will work to develop the EMEA investor franchise and build enduring relationships with investor clients.

Through Citi OpenInvestorSM, Citi offers complete investment services for institutional, alternative, and wealth managers delivering middle office, fund services, custody, investing, securities lending and financing solutions.

Street will report to Tom Isaac, the global head of client sales management for financial intermediaries, and Richard Ernesti, the global head of investor client sales management.

It has been reported that **Benjamin Happ**, former head of capital services in Asia Pacific, will move to the Boston offices of Credit Suisse.

Happ joined the bank in July 2009. He previously served as head of business development at Abax Global Capital, and prior to that, he worked in the prime brokerage division at Morgan Stanley.

Kevin Meehan, former head of prime services for Asia Pacific at Credit Suisse, also moved from the region, and will be residing in London as global head of prime fund services later this summer.

Meehan will be replaced by Myo Schollum, the Swiss bank's head of Asia prime brokerage sales, in Hong Kong.

The US SEC has named **Norm Champ** as director of its investment management division.

Since June 2010, Champ has served as deputy director of the US SEC's office of compliance inspections and examinations (OCIE). He took over from Eileen Rominger, who has retired, as director of its investment management division on 9 July.

In OCIE, Champ has served as the acting head of the broker-dealer, investment adviser/investment company and credit rating agency exam programmes, and as acting chief counsel.

"Champ has proven himself to be a natural leader and an expert at managing programmes that bolster our financial markets and protect investors," said US SEC chairman Mary Schapiro. "His breadth of experience and deep insight into so many aspects of the securities industry will well serve investors and the agency." **SLT**

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