SLT SECURITIESLENDINGTIMES

ISSUE057 TUESDAY 07.08.2012
securitieslendingtimes.com

ESMA shakes up securities lending for UCITS funds

PARIS 03.08.2012

The European Securities and Markets Authority (ESMA) has released guidelines on exchange-traded funds (ETFs) and other UCITS issues that affect securities lending and collateral diversification.

The guidelines were developed following a review of the current regulatory regime in Europe. ESMA found it to be "insufficient to address the specific features and risks associated with" index-tracking UCITS and UCITS ETFs and the efficient portfolio management (EPM) techniques, such as securities lending, repo and reverse repo, that they may carry out.

In a statement, ESMA added: "[T]hese guidelines are a valuable response to many of the issues identified in the on-going debate on shadow banking and will constitute an important step in the development of the regulatory framework of UCITS."

Some commentators have said that under the guidelines all revenue that is made from securities lending must be returned to a UCITS fund and its investors.

The ratings agency Moody's called the guidelines "credit negative for asset managers".

Moody's said that while the guidelines aim to increase investor protection and harmonise regulatory requirements within the EU, they are credit negative for asset managers that sponsor ETFs in Europe, such as BlackRock and State Street, and will hurt profitability as a result of higher compliance costs and curtailment of their profitable securities lending activities.

It said: "Securities lending provides ETF sponsors extra revenue to compensate for slim ETF management fees."

readmore p2

SLTINBRIEF

Latest news
Eight financial institutions have recently selected Reporter—Lombard Risk Management's regulatory solution
p5

Latest news
Oil and gas company CYGAM Energy, executes securities lending agreement
p5

Latest news
Rabobank International chooses Triquesta to implement new collateral and risk management solution
p7

Industry insight
The age of collateral management is here, but is it here to stay? Elaine MacAllan of Lombard Risk Management finds out
p8

Country profile
In the second part of a two part series on South Korea, SLT talks to Dane Fannin and Sunil Daswani of Northern Trust
p11

People moves
Swinburne resigns from Citi, James Tomkinson joins Rule Financial, eSecLending nabs Peter Economou and more
p19

Spain and Italy ban short selling

Spanish and Italian regulators have introduced short selling bans due to extreme volatility in financial markets. Spain's regulator the CMNV said that its prohibition will be effective during the next three months.

readmore p4

RBC introduces RBC Investor Services

The Royal Bank of Canada has taken full control of RBC Dexia Investor Services and rebranded the global custody, fund and pension administration services provider as RBC Investor Services.

readmore p4

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ESMA shakes up securities lending for UCITS funds

Continued from page 1

The guidelines, which Moody's does not expect to be implemented until early next year, could force ETF sponsors to return securities lending revenue. "[A]ll securities lending revenues, net of operating costs, must be returned to the ETF to compensate investors for assuming the associated counterparty risk."

The EDHEC-Risk Institute, which conducts academic research for businesses, welcomed ESMA's guidelines, but it said that it was "surprised by the boldness" of ESMA's proposal on securities lending revenue.

It said: "While it is only fair that investors receive the full benefits of the risks taken on their behalf, EDHEC had advocated a more modest approach that relied on disclosure and competition to improve terms for investors. The ESMA decision is a landmark decision that will force a dramatic reshaping of the European securities lending industry in a very short time span."

ESMA's guidelines state: "All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS."

In a statement, the International Securities Lending Association said: "This last sentence has been the subject of some press speculation which we think is exaggerated. Whilst the wording is not as clear as we would like, we assume that it is not ESMA's intention to preclude a securities lending agent (which could be the fund manager, custodian bank or a third party firm) from charging a commercially appropriate fee for providing their services."

"We are in the process of trying to get more clarity on this part of the guidance and will be in touch with members on this point in due course."

An ESMA spokesperson confirmed that all net revenue must be returned, but this does not include the cost of running a securities lending programme.

Moody's explained that ETF sponsors share securities revenue differently: "While some ETF sponsors, such as Comstage and Credit Suisse Group AG's Credit Suisse Asset Management, already return 100 percent of securities lending fee income to fund investors, others retain a percentage of the fee income for themselves. Some sponsors, such as EasyETF and SPDR ETF, keep up to 50 percent of the revenue."

UCITS funds that carry out securities lending have to inform investors about the activity and its associated risks, according to ESMA's guidelines.

The guidelines also allow a UCITS fund that is in a securities lending agreement to recall "any securities lent" at "any time" and "terminate any agreement into which it has entered", according to the ESMA statement.

On collateral, the guidelines require UCITS funds that receive collateral to mitigate counterparty risk in OTC derivative transactions or EPM techniques to ensure that the collateral "complies with very strict qualitative criteria and specific limits in relation to the diversification", added the ESMA statement.

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RBC introduces RBC Investor Services

Continued from page 1

RBC Dexia started as a joint venture between RBC and Banque Internationale à Luxembourg.

RBC and Banque Internationale each owned 50 percent of the business, but the French-Belgium bank was reportedly forced to sell its stake after it fell victim to the European sovereign debit crisis and the 2008 credit crisis.

RBC announced its intention to buy Banque Internationale's stake in RBC Dexia in October 2011 and signed a definitive agreement to do so in April 2012. RBC paid €837.5 million (C$1.1 billion) for the 50 percent stake.

"The industry fundamentals are very attractive and this business is positioned for solid long-term growth," said Jim Westlake, the group head of international banking and insurance at RBC. "We look forward to building on our strong relationships with clients in our goal to become the premier provider of investor services worldwide."

"We are excited about full ownership by RBC and have been encouraged by the response from our clients around the world since the announcement of this transaction in April," said José Placido, the CEO of RBC Investor Services. "Our clients will benefit from RBC's financial strength, complementary capabilities through wealth management and capital markets, and commitment to growth."

Spain and Italy ban short selling

Continued from page 1

This is until 23 October 2012 inclusive, that can renewed or lifted as needed.

Italy's regulator Consob introduced its ban at the same time as Spain in reaction to "serious turmoil in the financial markets". The ban applies to insurance and bank stocks only.

The ban was supposed to be lifted on 27 July, but it has since been extended until 14 September.

"Taking into account that the serious turmoil in the financial markets may threaten the stability of the financial system and the protection of investors, and taking into account the exceptional market conditions in the trading sessions of July 2012, characterised by high volatility and significant fall in prices," it was necessary to introduce the short selling ban in Italy, said Consob in a statement.

Spain's preventative ban affects any trade on equities or indices, including cash equities transactions, derivatives in regulated markets or OTC derivatives, that has the effect of creating a net short position or increasing a previous one, even on an intraday basis.

"A net short position means any position resulting in a positive economic exposure to falls in the price of the stock," added the regulator in a statement.

However, positions arising from market making activities will be exempted from the ban. The CNMV said of the exception:

"For this purpose, market making covers investment firms that incur in a transitory (especially intraday) net short position either as a response or a hedge to a client order, or as a result of quoting bid and ask prices on a continuous way as market members, with or without a public commitment with the issuer or the market."

Short selling bans have been rife in Europe since sovereign debt crises began to affect capital markets. Short selling has been banned or restricted in Italy and Spain before, and Greece has extended its short selling ban twice since August 2011.

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The European Securities and Markets Authority has been working on the Short Selling Regulation since 2010. Its aim is to harmonise European rules on the short selling of shares and sovereign debt, and it will become effective on 1 November.

Lombard Risk's Reporter adds eight new contracts

Eight financial institutions have recently selected Reporter—Lombard Risk Management's regulatory solution—in response to new European reporting regulations.

Common reporting (COREP) describes the reporting requirements of the harmonised European Capital Requirements Directive. The European Banking Authority (EBA) will mandate COREP as a standardised reporting framework from 31 December 2012.

Reporter's new users are all UK-based financial institutions. Under COREP, they will have to run new regulatory calculations for capital and large exposures, produce new reports in new formats that require more detailed information and use a new delivery methodology in XBRL (extensible business reporting language).

Lombard Risk's Reporter is designed for regulatory compliance at branch and/or head office level.

It has global coverage and offers "detailed supervisory computations", including all Basel III capital and liquidity calculations, according to Lombard Risk.

"Streamlined integration to multiple source systems is enabled by its rich ETL functionality, and stress testing and scenario analysis, now part of the regulatory scene, by Lombard Risk's LISA solution."

The new common reporting requirements are due to come into force in early 2013.

James Phillips, regulatory strategy director at Lombard Risk, said: "The precise calculations and report details are not yet finalised by the EBA. However, our experience in dealing with emerging regulation, and close working relationship with the regulators, gives us confidence in the data and calculations that will be required. Lombard Risk calculation engines and reporting templates will meet the final detailed requirements when they are published."

John Wisbey, the CEO of Lombard Risk, added: "We observe that some legacy regulatory vendors and their systems are either being left behind or acquired and inevitably new entrants are coming into the market with opportunistic offerings."

"However, we are seeing a move by financial institutions towards consolidating regulatory reporting requirements with established solution providers with a strong pedigree, proven heritage and a clear roadmap."

Newedge picks Fidessa

Newedge has selected the Fidessa trading platform and order management system for its global derivatives and equity trading business.

The first phase of this project, covering trading hubs in London and Chicago, is now live, and the platform will be rolled out across hubs in Asia this year.

"The platform will provide Newedge with a multi-asset trading workflow solution across their front and middle-office operations—incorporating global order management, access to Newedge trading algorithms, FIX connectivity and smart order routing tools," said a statement from Fidessa.

Nicholas Garrow, global head of eSolutions at Newedge, commented: "Fidessa's sophisticated multi-asset workflow offering—including an integrated, multi-asset algorithmic trading engine and centralised pre-trade risk and monitoring tools—will play an integral role to deliver next-generation capabilities to our global clients spanning all asset classes."

Stephen Barrow, global sales director at Fidessa, added: "We believe that the firms that can harness the regulatory momentum that is bringing together the worlds of OTC and exchange-traded derivatives will have a significant competitive advantage."

Oil and gas company executes sec lending agreement

Oil and gas company CYGAM Energy, which is based in Canada, has executed a securities lending agreement (SLA) with one of its controlling shareholders.

Under the SLA, the company has borrowed 200,000 common shares from Peyto Exploration & Development Corp on a non-interest bearing, unsecured basis.

CYGAM must return the shares to Peyto Exploration & Development within 270 days of the date of the SLA, or following a financing or sale of assets by CYGAM yielding cash proceeds in excess of $5 million.

It plans to use the shares as collateral under its credit arrangement with a recognised Canadian financial institution. It wants to secure funds of up to 50 percent of the market value of the shares for ongoing capital requirements and general working capital purposes.

Paladyne unveils new data suite

Paladyne Systems, a Broadridge Financial Solutions company, has a new release of Paladyne's Reference Data Suite, which services assets that are operated by hedge funds, investment managers, fund administrators and prime brokers.

"Given the laser-focus of the industry on improving the quality of their data while cutting the cost of managing reference data, we have added new functionality to the Paladyne Reference Data Suite to meet these needs," said Sameer Shalaby, president of Paladyne Systems.

"In addition, there is an increased focus on regulatory reporting within the industry and Paladyne is helping clients with a centralised reference data repository, clean data, and streamlined data flows to mitigate operational risk."

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Key enhancements to Paladyne Reference Data Suite include a data governance module, and Form PF reporting.

Lombard Risk bags another three contracts

Lombard Risk Management has secured three new contracts.

One contract will see Lombard Risk license and implement its Colline collateral management software to a US-based international fund management group.

The contract covers Colline's modules for OTC collateral management, clearing and management information reporting, and has a first-year value of approximately £500,000.

John Wisbey, the CEO of Lombard Risk, said: "We are delighted to have been able to add this prestigious US fund management client to our very high quality client list for Colline. As for other recent contract wins, the addition of clearing and our Reporter MIS product to Colline was a major factor in winning this deal and we believe these modules together with those for repo and securities lending will allow us to generate useful additional revenue from other clients in the coming year."

The other two new contracts relate to new European reporting rules.

Common reporting (COREP) describes the reporting requirements of the harmonised European Capital Requirements Directive. The European Banking Authority (EBA) will mandate COREP as a standardised reporting framework from 31 December 2012.

The two new contracts are for Lombard Risk's COREP programme, bringing the total number of contracts to 13.

Bombay Stock Exchange bans 52 stocks from sec lending

The Bombay Stock Exchange has excluded 52 stocks from securities borrowing and lending trades.

The ban will begin on 28 September. Banned stocks include Oil India, GlaxoSmithKline Pharmaceuticals, Tata Coffee and Jet Airways India.

The exchange said: "[T]he members of the SLB segment are hereby informed that 52 securities have ceased to fulfill eligibility criteria."

Fidelity Capital Markets to release a prime brokerage pricing service

Institutional trading firm Fidelity Capital Markets is preparing to launch a securities lending pricing service that could make the market more transparent for its clients.

Fidelity Capital Markets houses the prime brokerage business of the mutual fund company Fidelity Investments. It offers prime brokerage services to its clients through Fidelity Prime Services, as well as a separate securities finance programme.

Its yet-to-be launched pricing information service will allow its prime brokerage clients to see the rates that are on offer from prime brokers for specific securities.

A client will only be able to see prime broker rates from Fidelity Capital Markets and the prime brokers that it uses, and only that client will be able to see those specific rates.

It has been reported that Fidelity Capital Markets has met resistance from other prime brokers that do not want to provide their rates in case it affects prices.

The unnamed service is being tested with select prime brokerage clients and is expected to launch in a few months.

OCC sees rise in July 2012 securities lending volume

OCC's securities lending central counterparty activities saw a 19 percent increase in July 2012 when compared to the same period in 2011, with 80,674 new transactions.

Its year-to-date stock loan activity is up 16 percent from 2011 with 539,252 new loan transactions in 2012. The average daily loan value at OCC in July was $33,573,733,743.

OCC's cleared contract volume reached 309,599,417 contracts in July, which represents a 12 percent decrease from the July 2011 volume of 351,117,113 contracts.

Its year-to-date total contract volume is down 7 percent with 2,410,587,457 contracts in 2012.

OneChicago surpasses 2011 block trading volume

Equity finance exchange OneChicago's block trading volume in the first seven months of 2012 surpassed more than 2.5 million contracts, exceeding all blocks activity in 2011.

Its July 2012 volume of 369,694 was up 219 percent year-over-year when compared with July 2011.

July 2012 exchange futures for physicals (EFPs) were up 55 percent from the previous month, and more than 350,000 EFPs and blocks were traded. EFPs and blocks activity represented $2.1 billion in notional value in July.

More than 85,000 of July 2012 futures that were valued at more than $558 million were taken to delivery.

Internationals drop and equity ascends at Eurex

In July 2012, the international derivatives markets of Eurex Group recorded an average daily volume of 8.1 million contracts, a drop from the 10.1 million seen year-on-year.

Of those, 5.8 million were Eurex Exchange contracts (July 2011: 7.2 million), and 2.3 million contracts (July 2011: 2.9 million) were traded at the US-based International Securities Exchange (ISE). In total, 127.6 million contracts were traded at Eurex Exchange and 48.1 million at ISE.

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At Eurex Exchange, the equity index derivatives segment also dropped, from 72.5 million to 63.8 million contracts year-on-year. The single largest contract was the future on the EURO Stoxx 50 Index with 25.8 million contracts.

The equity derivatives (equity options and single stock futures) segment at Eurex Exchange grew by 23 percent year-on-year, reaching 29.5 million contracts. Equity options totalled 17.9 million contracts and single stock futures were at 11.6 million contracts.

Eurex Repo, which operates Swiss Franc Repo, Euro Repo and GC Pooling markets, reported in July 2012 for all Eurex Repo markets an average outstanding volume of €239.4 billion, a drop from the €292.9 billion seen in July 2011.

However, increases were found at the secured money market GC Pooling, recording an average outstanding volume of €156.3 billion, and an increase of 48 percent year-on-year, as well as the Euro Repo Market, which reached an average outstanding volume of €195.3 billion in July, an increase of 46 percent year-on-year.

Rabobank selects Triquesta

Rabobank International has chosen Triquesta to provide it with and implement a new collateral and risk management solution.

Rabobank International chose Triquesta Collateral Manager for the daily collateral and risk management monitoring of its trade and commodity finance activities. The implementation has already begun and the system will be operational in all global offices of Rabobank International.

The Triquesta Collateral Manager is a collateral and risk management suite for banks active in trade and commodity finance. The management of each facility agreement between the relevant parties, which is the basis for drawdowns and issuance of credit instruments against self-liquidating collateral, is one of the core qualities of the system.

The solution includes a module for managing a variety of commodity repos. Its margin financing functionality is "unique and allows for financing of the most complex hedging structures", said Triquesta.

"We are delighted with Rabobank International as the first user of our system. Rabobank is a highly reputable bank and an established global player in commodity finance," said Martijn Voorhuis, a director at Triquesta. "We have invested a number of years to complete our collateral and risk management solution that allows for monitoring of complex structured commodity finance deals. With Rabobank adopting our solution, our product is ready for market acceptance."

"Triquesta understands the trade and commodity finance business very well and knows how to translate these requirements into software," said Fred van Hedel, the global head of risk management trade and commodity finance at Rabobank International.

Pieter Fortuin, IT risk manager at Rabobank International, added: "We have audited the product of Triquesta and concluded that the code is well structured and robust. The technology choices are in line with Rabobank International standards."

Boston Prime partners Tradency

FX prime brokerage Boston Prime has partnered with Tradency, the developer of Mirror Trader, to offer trading technology to Boston Prime's FX prime brokerage customer base.

Mirror Trader is a platform providing traders and brokers with tools including live signals, sentiment, market charts, oscillators, chart studies and social trading abilities.

"Our number one objective is to help our forex brokerage customers to be more successful. Mirror Trader offers tools that allow traders to improve their performance, which leads to increased trading volumes," said Mitch Eaglstein, the managing director of Boston Prime.

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Crunching the collateral numbers

The age of collateral management is here, but is it here to stay? Elaine MacAllan of Lombard Risk Management finds out

INDUSTRY INSIGHT

Lombard Risk Management recently held an online business seminar on repo and securities lending collateral management. The seminar tracked the formation and expansion of collateral management in investment banking since the late 1990s, current practice, contemporary issues, drivers for change and current market initiatives.

This article expands on the seminar and provides insight into repo and securities lending in the global collateral management marketplace.

The formation and expansion of collateral management in investment banking

The sudden and intense focus on the requirement to cover counterparty credit risk in the late 1990s spawned technological and operational solutions that are still evident in repo and securities lending margin practice today.

The Russian MinFin and Long Term Capital Management crises of the late 1990s sparked the financial industry's first hard look at collateral management practice. Market participants began to realise that exposures were inadequately covered. Systems were designed to automate collateral management calculations and processes—either built and supported in-house or via early vendor margin platforms. These offered simple but effective support, though with limited functional flexibility. Margin terms captured in collateral agreements at the time were often scant, resulting in bilateral margin call agreements that were developed on the basis of precedent and the limitations of participants' IT systems. This led to a variety of margin calculations and processes that available technology simply could not support. Manual intervention and adjustment became commonplace. As most participants supported repo and securities lending margin operations on different technology platforms, standards became increasingly diverse, despite broad similarities in products.

As daily margining became standard practice in the repo and securities lending markets, the OTC derivatives markets were expanding rapidly, with an unprecedented volume and variety of exotic instruments being traded and requiring collateralisation. The form and complexity of these instruments, coupled with the comparatively detailed and precise margin terms that were held within the Credit Support Annex of International Swaps and Derivatives Association (ISDA) documentation, demanded sophisticated technology solutions. Complex workflow-based margin systems emerged to support OTC margin operations, but were not consistently replicated in the repo and securities lending markets.

Following the 2008 financial crisis and resultant collapse of Lehman Brothers, regulators focused intently on OTC markets where portfolios and exposures were large and difficult to unravel. Firms duly responded by improving the efficacy and efficiency of their operations. In comparison, secured repo and securities lending portfolios were relatively easy to close out or further secure through the adoption of prudent pricing or haircut strategies. Regulatory scrutiny, and with it the drive to develop and improve margin technologies, was limited in comparison.

Regulatory reform and collateral management

Today, regulators are increasingly looking at collateral management policy and practice as a means of controlling and reducing market and counterparty risk, and of reducing the likelihood of bank default. Recent rule-making means financial institutions will be obliged to source and provide more collateral of a higher quality under both bilateral and central clearing agreements. Estimates suggest that additional global liquidity requirements under Basel III will reach €2.89 trillion, while US Dodd-Frank Act and European Market Infrastructure Regulation legislation and global equivalents will further increase capital requirements.

As a result, a global squeeze on the availability and cost of collateral is anticipated, putting intense pressure on firms to source and exploit collateral more cost-effectively. In response, firms are now seeking greater operational efficiencies in their margin programmes and optimal collateral inventory performance.

The requirement for increased levels of higher quality collateral is likely to increase the volume of repo and securities lending activity among

existing market participants, plus drive an influx of new entrants as firms seek to maximise their use of available collateral or source collateral that would not have been required pre-regulatory reform. Firms that are unable to satisfy their clearing collateral requirements directly from their proprietary inventory will have two options:

- Utilise the collateral transformation services provided by the direct clearing members of clearing houses—with the associated cost; or
- Access the repo market directly as a relatively cheap and secure source of collateral.

More regulatory change is in store for the repo and securities lending markets. The Financial Stability Board is due to publish proposals during 2012, although it is not yet clear what form proposed changes are likely to take.

Margin operations and processes in the securities lending and repo markets

Documentation standards

Repo and securities lending portfolios are supported under separate and distinct documentation terms. Exposures cannot at present be netted.

Margin terms in repo documentation (Global Master Repurchase Agreement, or GMRA) that define operational processes are limited in comparison with Global Master Securities Lending Agreement (GMSLA) and ISDA terms, although this is changing with the publication of the European Repo Council's revised operational guidelines for repo margin this year. The council is likely to provide recommendations including trade coverage, minimum transfer amounts and call schedules.

Standard repo margin terms are bilateral, frequently based on precedence and with space for negotiation; the GMRA does not commonly support the imposition of terms by one party. The unintended consequence of this is a variety of bilaterally agreed operational processes that repo systems have struggled to capture and support, both operationally and in terms of flexible exposure calculation.

In contrast, securities lending documentation standards have tended to contain more detail, with terms defined and imposed by the lender, including trade eligibilities, call and settlement schedules, collateral eligibilities, concentration/correlation limits and pricing terms.

GMSLA agreement terms tend to be more standardised, following a general 'lender is king' principle. Nevertheless, terms can be complex and may include (or exclude) trades based on margin type, prepay and settlement status. Further, multiple margin events or movements may be made during the course of one day. Technology solutions have struggled to support the full range and complexity of these terms and processes.

Trade eligibilities

GMRA documentation currently lacks a standard definition of the rules relating to the inclusion of trades for exposure calculation purposes (although European Repo Council recommendations due this year are likely to address this). Discrepancies in market participants' inclusion/exclusion of trades for margin call calculation purposes, according to start/end dates and settlement status, are commonplace. Again, technology solutions have lacked the flexibility to support these operational variations.

Workflow

Repo margin calls tend to be made on a net basis, and settled either with free cash or securities collateral. Re-pricing is also standard practice and supported in front office or within the collateral team. Operationally cumbersome, this process involves physically closing and re-opening each transaction, with exposure covered by the physical settlement of trade cash rather than the movement of free collateral. There is a tendency towards attempting to apportion margin calls within a net portfolio according to asset type or trading desk, though very few firms are able to support such a process operationally or technically.

There is a peculiarity in securities lending margining practice, where in almost all cases fixed income trading and equities trading under the same master agreement will be margined separately. This is in large part due to technical capacity and the fact that most firms use different margin platforms for each business line. In addition, it is common for the equity margin call to be covered in multiple parts. For example, a large and mixed portfolio may involve moving collateral across cash pools, marking rebate trades and moving free of payment securities—resulting in four or five different margin movements all on the same day.

Calculation schedules

In the repo markets, the margin process tends to take place on an overnight basis. Technology platforms generally support close-of-business trade capture and pricing. As a result, firms encounter difficulties when attempting to recalculate exposure and agree margin calls on an intraday basis, in particular under stressed market situations.

In contrast, in securities lending markets, intraday margining is common. Calculations are revised dynamically as the status of loan settlements is updated.

Pricing and trade valuation

Prices that are used for mark-to-market trade valuation purposes are usually agreed between parties in the repo markets. In the event of a dispute, general practice is to revert to front office to agree bilaterally which price should be used. Global variations in calculation methodologies are common, leading to multiple adjustment processes to agree margin call exposures. Intraday recalculations are usually not available as firms mostly operate close-of-business systems.

Securities lending calculation methodologies are driven by technical capabilities. Intraday recalculation is commonplace, but the ability to support multiple methodologies or prices on a single system is still rare.

Disputes

Compared with the OTC derivatives market, disputes in the repo and securities lending markets are easy to resolve. Portfolios are comparatively small, trades can easily be proven to have either physically settled or failed, and prices are generally readily available for liquid securities.

Portfolio reconciliation platforms are available to aid dispute resolution in the securities lending markets. However, they tend to be vendor or internally supported solutions and separate from margin platforms. Repo reconciliation, and the reconciliation of collateral positions, is still largely supported manually. The most efficient and controlled operational process is to embed trade and collateral reconciliation into the dispute process on the same technology platform as the margin workflow.

Client reporting

Bespoke client reporting is limited on standard repo and securities lending platforms. Client reporting tends to be carried out manually or achieved through an additional reporting integration layer that can retrieve and transform the necessary data from the margin systems into the required formats. The optimal process is to produce client-driven reporting in flexible formats, on an adhoc (real-time) or scheduled basis, direct from the margin system.

Internal reporting

Particularly in the case of medium to large participants, internal reporting is generally constrained by the fact that data is held and produced in product silos. Firms' trading and collateral platforms—and the data flowing from them—tend to be separate. As a result, consolidating data and gaining a cross-product view can be an enormous task.

Contemporary issues facing established markets and technologies

At the Global Securities Financing Summit in Luxembourg earlier this year, delegates were polled on their primary financing concerns. More than 80 percent of respondents cited either collateral or operational risk.

Other poll results from the summit similarly reflect firms' preoccupation with technological hurdles. When asked which internal inefficiencies had the biggest impact on managing collateral, "inability to manage collateral centrally" or "incomplete view over collateral balances" made up 39 percent of responses.

Process automation and calculation and pricing flexibility are particular areas of concern. Booking controls should be automatically embedded into technology workflows to support the validation of collateral eligibilities, concentration limits and sufficiency checks. Margin systems should prevent the booking of ineligible collateral, and where possible, assist in the identification of the most appropriate/optimal collateral. Dynamic exposure calculations should be enabled via real-time hook-ups to upstream and downstream

data sources. Automated statements and reconciliations should be supported, reducing the need for third party external solutions.

Firms need the technological flexibility to support the wide variety of margin methodologies that are employed globally without manual intervention, and the ability to re-run calculations on an 'any-time' basis, especially in market stress scenarios. There is a growing need to forecast exposures, and simulate 'what-if' scenarios to enable and maximise efficient collateral inventory management.

Product silos need to be broken down. While products and collateral inventories continue to be managed across different technology platforms, it remains difficult to gain an holistic, cross-product view of risk, to optimise firm-wide collateral inventories, or to provide the consolidated and bespoke reporting that clients demand.

As a result of all of these issues, many firms are reviewing both the efficiency of their collateral programmes and the capacity of their margin technologies to support their growing business needs.

Cross-product market initiatives and solutions in collateral management

Data integrity

Firms need to prove and improve data integrity and operational control by carrying out transaction reporting and reconciliation on a global basis. Proactive data sharing and automated portfolio reconciliation will assist in this respect, as will gaining global buy-in to improve the quality of dispute resolution techniques (for example, the ISDA dispute protocol initiative).

Technology

Improving the efficiency with which collateral is managed is proving a challenging task. One of the biggest headaches that is endured by companies is IT complexity in the form of product silos, multiple systems and data sources and lack of technical integration. Significant initiatives in this space include the move towards single-platform, cross-product margin systems and electronic messaging.

Cost and efficiency

Pressures on collateral availability and cost are driving a focus on operational efficiencies and cost reductions within the collateral management programmes of many firms. They can achieve this in a number of ways, for example, by sourcing collateral more effectively and streamlining their operational processes. The introduction of exception-based processing is a useful step, as is the use of a single, cross-product margin call and consolidated reporting.

Solution to the problem

Financial institutions should remove the technological barriers between product silos that prevent them from gaining a clear view of their collateral management activities. Salvation potentially lies in the introduction Lombard Risk's single system platform, capable of supporting all a company's margined products, providing a consolidated view of a firm's collateral inventory and so enabling the optimisation of collateral across all margin agreements. The netting of margin requirements also then becomes possible, either from a reporting or a physical settlement perspective. And finally, client reporting can be consolidated, providing the company and its client with a view of the whole of their real exposure, across all products, to any given counterparty. **SLT**

Click here to receive a link to the recording of the webinar: 'Collateral management—repo and securities lending'

Elaine MacAllan
Business matter expert and product consultant
Lombard Risk Management

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Tying the hands of a short seller

In the second part of a two part series on South Korea, SLT talks to Dane Fannin and Sunil Daswani of Northern Trust about the effects of short selling bans as a means of boosting financial recovery

MARK DUGDALE REPORTS

Short sellers continue to have a difficult time globally as governments and regulators try to boost financial recovery. Short selling bans have been implemented and lifted throughout Europe and Asia since the financial crisis hit in 2007, with Spain and Italy being the latest countries to reintroduce bans on a practice that is important to many securities lending strategies.

South Korea implemented a ban on short selling in October 2008, but lifted the ban on non-financial stocks in June 2009. It then banned short selling on all listed stocks again in August 2011. The short selling ban was lifted for non-financial stocks in November 2011, but financial stocks continue to be banned from short selling.

SLT talks to Sunil Daswani, Northern Trust's head of international client relations for securities lending, and Dane Fannin, Northern Trust's head of equity trading in the Asia Pacific region, about short selling in South Korea and the effect that bans have had on the market.

What is the current situation is South Korea?

Dane Fannin: Much of the offshore securities lending demand is being driven by market neutral equity long and short hedge funds that typically employ fundamental analysis to identify over and undervalued securities. There are also various statistical arbitrage strategies that are employed to take advantage of the relative mispricings between securities on a time series method, although these are less common. To our knowledge, there have been no offshore hedge funds that have established an onshore presence to tap into the domestic space, despite recent regulation to allow this. However, we are aware of the presence of local hedge funds, although offshore prime brokers are unable to service such clients given the lack of local presence, which requires substantial capital outlay.

What role does short selling play in a sec lending strategy?

Sunil Daswani: It's important to recognise that although one supports the other, securities lending and short selling are two entirely different activities, despite being commonly interchanged. A short sale is typically the second leg of a hedging strategy that is employed to generate a return by seeking to profit from an arbitrage opportunity between two mispriced assets or sectors, for example. Without the ability to borrow the security and subsequently short sell, the trade is entirely exposed to market risk and so may be too risky to pursue. It should also be said that short selling plays an important role in providing the market with liquidity and efficient price discovery.

Why and how did South Korea ban short selling?

Fannin: Although the correlation between a falling stock market and short sale volumes has not been established, regulators remain cautious, particularly in light of the Asian financial crisis.

In August last year, the South Korean regulator imposed a three-month covered short sale ban for all securities amid broader market volatility and concerns over a falling stock market, which was believed to have been driven in part by short sellers. The ban was lifted in November 2011 for non-financials only and a naked short sale ban remains in place indefinitely for all securities.

What effect have short selling bans had on hedge funds and other borrowers in South Korea?

Daswani: Despite existing rules as well as the risk of further short sale bans in future, and the difficulty in hedging against such regulation, South Korea remains an attractive market in terms of returns to beneficial owners. While volumes are perhaps lower than they would be if the ban on financials were lifted, investors are likely to continue trading albeit with added caution. We see this theme in other emerging Asian markets, including Taiwan, in which revenue prospects outweigh the risk of punitive regulation. It is these markets that remain the key focus for agent lenders and their clients as the region continues to grow.

If the short selling bans are not lifted, what else could be done to attract hedge funds and other borrowers to South Korea?

Fannin: Ultimately, it is the broader economic environment that is challenging the potential growth in South Korea, and indeed in other locations around the globe. Hedge funds are unlikely to be convicted until volatility subsides and correlation returns. In the short run, however, more regulatory transparency would certainly benefit the wider investor audience in South Korea as this would likely instill confidence and encourage investors to deploy additional capital in the market. Conversely, it is equally important for market participants to work closely with regulators to ensure the operation of efficient markets while preventing market manipulation or abuse and avoiding any unintended consequences. **SLT**

Quality over quantity: IT in securities finance

SLT catches up with Sander Baauw and Raymond Vuyst of Synechron about how they are steering the IT company towards a strong securities finance brand

MARK DUGDALE REPORTS

Why did you decide to join Synechron?

Sander Baauw: Raymond Vuyst and I were both at ABN AMRO, and before that we were at Fortis GSLA for more than 10 years. I was running the equity finance desk and Raymond Vuyst was running the IT solutions department for equity finance and equity derivatives. We never thought about leaving ABN AMRO, but Synechron gave us the unique opportunity to set up a fully fledged global securities financing business consultancy practice on top of the already existing successful IT solutions and services practice.

Raymond Vuyst: Synechron is a privately owned young, dynamic company that was founded in 2001. It is profitable since inception and is growing every year—it has 4000 members of staff at the moment but that is increasing every month—and it has an open culture that stimulates any new idea. We thought that this is the kind of company that we want to work for and move ahead with.

Where do you see the consultancy practice heading?

Baauw: There are different kinds of consultants around in the market, but they can usually be put into four categories. There are the pure business consultants that do very expensive 200-page presentations on organisation and governance, which are general and not really specific to a particular market, such as securities finance. Then there are the massive IT consultancy firms from India that service a variety of industries but with a limited amount of specialised domain expertise in a niche market such as securities financing. And there is the one-man band that does specialised work.

Vuyst: We do not fall into any of these categories—we fall into the fourth category. In the past, Synechron's practice has always been focused on banking, financial services and insurance IT services and solutions. Now, with the new strategy, business consultancy is an extra specialty on top of it. Our style of consultancy is really hands-on and focused on pragmatic execution. We do not have a consultancy background, but our differentiator is that we have been practitioners for a long time in the centre of the entire value chain of securities financing and we have experienced it all ourselves. In addition to this, we have enough back up from our very experienced IT staff to scale up and down fairly easily during a project.

What do you do when you are called into a business?

Baauw: We see what we do as a four-step programme. We do business consultancy as step one and this could cover, for example, a SWOT analysis, a gap analysis and an execution plan for the next couple of years. This could then result in strategic decisions such as opening a desk in a new jurisdiction because there is more flow coming up due to new market circumstances. The second step is analysing the existing IT environment that is in place. This means that we look at the current IT systems and review

whether these systems will continue to function properly during the next few years according to the requirements. The other options are to build an entirely new system or to buy one.

Vuyst: Once this analysis is made, we move to the third step, which is testing, application development, documentation, and making sure that everything has been executed and implemented according to the client requirements. The fourth and final step is support and monitoring, from both a functional and a technical angle. This can all be done in cooperation with the internal IT department and/or other vendors. Alongside this, a key component of each project is to decide with the client what the optimal ratio between onsite and offshore recourses is in relation to quality and cost.

Baauw: Those are the four steps that we offer when going into a business, but some clients do not require us to carry out all of them. Some clients will need just consultancy services, while others want us to analyse, implement and execute, and then carry out testing and so on. Of course, a specific combination of these steps is always possible, but what we also heard a lot when we were speaking with people at the International Securities Lending Association conference in Madrid was that opting for a combination of steps could cause problems.

Vuyst: The main problem that could arise is the interpretation of documentation that is created by another participant in the value chain and this could result in a lack of clarity and disconnect. But of course we offer and do all four disciplines separately or in any possible combination.

How do securities finance businesses tend to operate—do they go for all four steps or a combination?

Baauw: Most of the time you see a combination, but from time to time you see the entire chain. You see this, for example, in the set up of a new desk or when the plan is to launch a new product. But there is not really one answer to this question because every bank and trading desk has a different structure, scale, number of entities, complexity of products, and so on.

Vuyst: We have seen companies with really sophisticated IT environments, which only look at step four, so we monitor and maintain their legacy systems offshore. Others could be a start up, in a growing phase or undergoing a re-organisation, so they need all kinds of advice and analysis on all kind of topics.

Baauw: On the other hand, sometimes you see trading desks or investment banks thinking that they require a different system to adapt to upcoming changes so they can grow to the next level, but they do not really need it. They only want to buy and bring in a brand new system because they have worked with their existing system for so long and they think the grass looks greener elsewhere. When we come in, we can look at these things with a fresh pair of independent eyes and advise accordingly. If we do not need think that the systems or processes need to change, then this is what we will advise because we always aim to have a transparent relationship with our clients for the long run.

How are securities finance trading desks doing at the moment?

Baauw: Everybody knows that the golden years are behind us and I doubt if they will come back in the next coming years. The securities finance trading desks are trying to keep up flow, which is certainly not always easy, and they are also dependent sometimes on external factors. The larger firms will always get some flow and most of the time they will try to spread it to the larger firms on the other side. But the smaller or medium-size trading desks have the advantage that they can quickly change to a different strategy or adapt to a new situation. This is also what we sometimes see on the IT side. If there is a large bank with multiple locations and with 10 different systems, it is not always easy to change something. If you have one desk with four equity finance traders, two people on the collateral desk, one repo trader and a couple of people on the operations, it is easier to change the IT environment.

Vuyst: The trading desks are always looking for new opportunities, but that is not easy to find these days. On the other hand, the result of this is that the front office is not only becoming more cost aware, but is also becoming more value aware. They are assessing whether the environments and processes in which they operate are still optimal for them. They are very aware of other things—not just trades and new opportunities and so on—they are also looking at the operational and technical sides.

Baauw: The process that Ray Vuyst described has of course had the same impact on on profit and loss. Another aspect, which is also changed, is the client side. In the past, it was easier to grow profit on the client side. Finding new clients was just easier to do 10 years ago. It was possible to visit all kinds of countries and find smaller, new players that you had never traded with before. Nowadays, if you—under the existing circumstances—try to do the same you will experience more obstacles from the enabling units that are more careful about risk, compliance and procedures.

Vuyst: One of the other major shifts in interest of the trading desks for the last couple of years is on the collateral side. The pricing of asset classes is done in detail these days and this can make or break your trade. Next to this, the global inventory management of collateral for an entire company is extremely important across all disciplines. To have this entirely automated and with real time reporting and dashboards is one of the biggest challenges for all stakeholders.

What are you charged with achieving at Synechron?

Baauw: We are focusing on securities finance worldwide with a strong focus on business consultancy and IT solutions and services. But in Europe, we are also trying to expand in other areas of the capital markets, such as commodities, via the existing contacts that we have built up in the securities finance market during the last decade.

Most of Synechron's clients have stayed with the company for years and they continue to do so. Without achieving customer satisfaction and creating that staying power, a company can have a very bumpy clientele where clients come and go, which means that there is no pulling power behind the brand. Synechron is not in this situation—when it attracts clients, they stick around.

Vuyst: This is what we want to replicate and build on in securities finance. We want to develop an even better brand and also become well known in our market. We can do this on three ways: (i) expand the work that we do with current clients, not only in securities finance but in different areas that the client operates in as well; (ii) attract new clients, because there is still a lot of potential clients that do not know Synechron, especially in this area; and (iii) set up and expand the business consultancy practice.

Although we are a fast growing company, our goal is not to be the biggest in the market, but we try to be the best in the market. This way we automatically gain good and solid client references by focusing on client satisfaction. This is a core value of the company. In securities finance, we will get customer satisfaction through excellent execution and being able to work in an agile way with a client and other parties that are involved. **SLT**

Raymond Vuyst
Managing director—continental Europe business
Synechron

Sander Baauw
Managing director—continental Europe business
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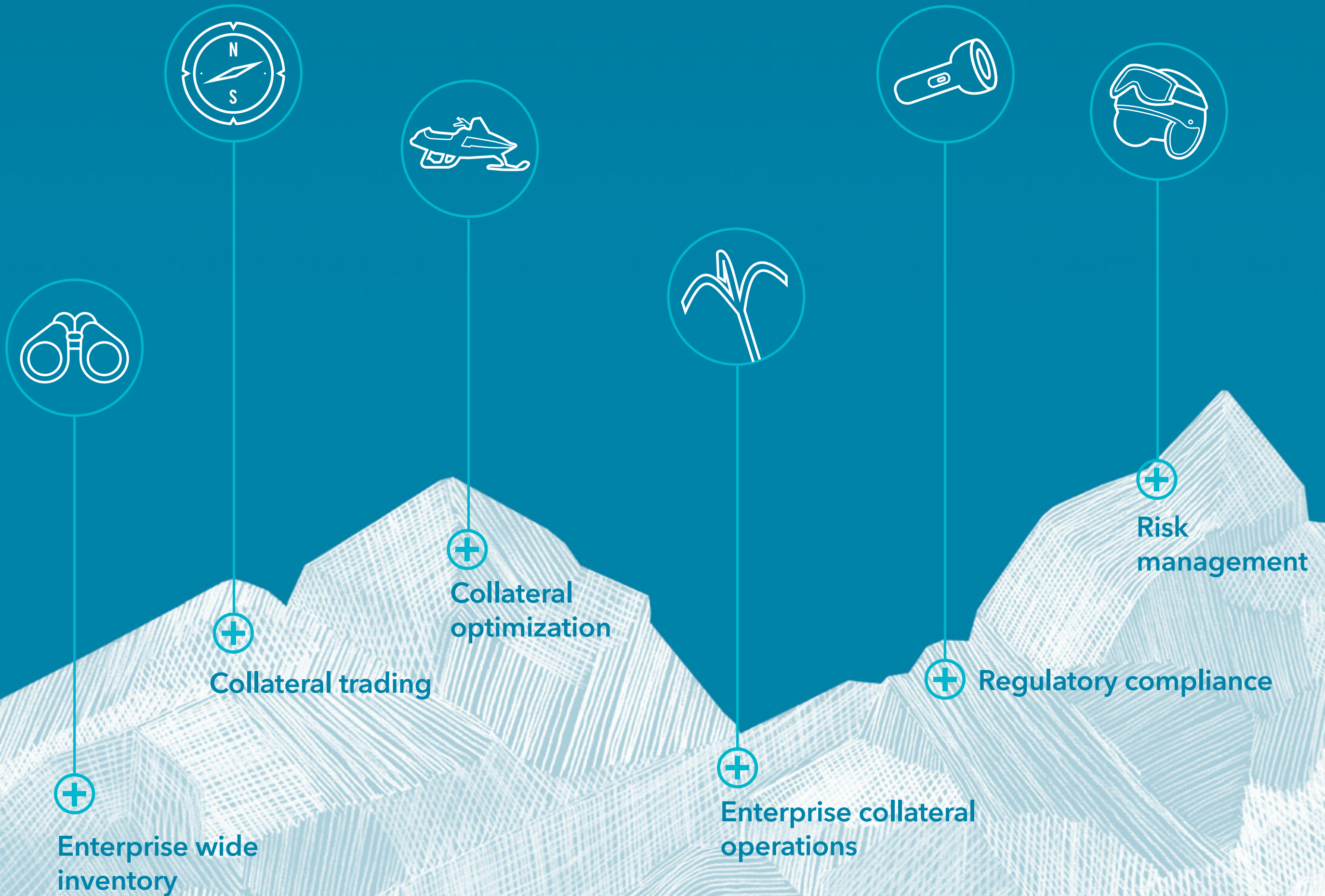

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Transparency, practically speaking

David Lewis of SunGard's Astec Analytics looks at how transparency would work in the real world

TRANSPARENCY REVEALED

Recent European Securities and Markets Authority (ESMA) proposals and upcoming ones from the US SEC are all concerned with transparency. Much has been written about the benefits and dangers of transparency, and yet still there remains the belief that transparency in everything is good. It is certainly the case that transparency is an essential part of an open and efficient market, but we should not be so quick to support all forms of transparency since transparency is not an end in and of itself.

Looking across the securities lending market, we can see parallels with many other sectors of the financial markets, as well as social ones such as health and education. For example, many parents in the UK have pored over league tables to help us to determine the best schools for the next generation of securities lenders. Unfortunately, we do not always have the success that we were hoping for as we struggle to differentiate schools on such basic measures. Herein lies the rub: there is a significant difference between data and actionable information. Even worse, transparency itself does not make a distinction between these two very different types, and the information that is trying to be delivered can get lost or worse, misunderstood.

Transparency is not to be confused with disclosure, of course; disclosure should be absolute, whereas transparency needs to be appropriate and proportionate. Disclosure can help clients to decide whether to purchase a service or not—take a very possible example of a beneficial owner of securities whose asset manager, agent lender, borrower and cash collateral money market fund manager are all from the same parent group. The fact that this situation could arise would have been, quite properly, fully disclosed to the beneficial owner in the programme's documentation, but the actionable information might only became apparent once all the pieces have been knitted together into a fully reported picture. Remedial action may well arise, as has happened in several similar instances.

Disclosure can also be about fees—if a service costs too much, then you will change providers, whether it is for your domestic electricity or your securities lending provider. As stated above, ESMA has just released new guidelines that suggest all revenues that are earned by repo and securities lending should be returned to the fund lending the assets and thence the beneficial owner. The industry has sought clarity from ESMA, and it appears that this was more directed at the asset manager that, in some cases, takes a management fee in addition to the fee split that is taken by the beneficial owner's lending agent.

Fee splits are a fundamental part of the economics of securities lending, and it is quite proper to pay for the use of a global lending team, infrastructure, balance sheet protection and collateral management as well as peripheral services that run alongside such a programme. The amount of the fee split has always been a closely guarded secret between client and provider, and often it actually is a key part of the decision making process when selecting a provider—a factor that is arguably given more prominence than it warrants. Too high a share and the beneficial owner will more than likely go elsewhere.

But what of the split—if there is one—that goes to the asset manager? While it is relatively rare, the three-way split does occur, hence the new rules. But the values can vary dramatically, as can the services that these fee splits are deemed to cover. Regulating them out is not the solution: disclosure is. Few would argue against paying an appropriate fee for a job well done, where responsibility is taken and value is added. Disclosure of any such fee allows the client to make a reasoned decision. When the asset manager in our previous example realises that its asset manager was also taking a slice of the securities lending revenues for 'programme oversight'—along with every other part of the chain taking a share of the revenues—it may not be impressed. Disclosure was present, but the key is to make that information actionable. Otherwise there is a surprise, and no one likes those.

But what of data and actionable information further forward, up the transaction chain? As a data provider, SunGard's Astec Analytics gathers information on more than 2 million trades a day, with more than seven years of daily historical data available to users online, which is built on more than 2 billion trades in the database. As one client opined: "Getting your arms around that kind of volume of data is like biting a six-inch thick peanut butter sandwich." Turning it into actionable information is the key.

Looking at some examples of this, we can see how with the potential flood of data, the consumer risks either missing the underlying message, or worse, misunderstanding it.

Figure 1 shows the balances on loan (blue plot) for European equities from April 2011 to 30 July, 2012. The European dividend season peaks can be clearly seen in both balances and the weighted average fee peaks (red plot). Note that the peak balances are down from 2011 to 2012, but the weighted average fees charged are up. This is not only useful information—actionable information, if you like—when looking at lending/borrowing strategies and planning revenue budgets; it is also highlighting other issues that are worth considering.

Looking beneath the data at what is not immediately apparent from the graph, we can also see that durations have got shorter. Take the CAC40 as an example. In 2011, weighted average durations in May were 24 days. In May 2012, they were down to 16. Loan turnover (new loans and returns over outstanding balances) increased from 23 percent to 50 percent.

What can be deduced from this, and what further questions would need answering? The shift could simply be the effect of constrained balance sheets encouraging shorter, more focused loans, but it could also be a result of the increasing cost of quality collateral that is needed to insure such loans.

Blending the changes in fee levels that can be seen from the chart, we can also measure another result: rates that are charged have risen while the value of the assets that have been lent has fallen overall. The general fall in the European markets has an effect on the value of assets on loan, of course, but we must also consider the effect of the much discussed shift to intrinsic value lendinger—the focus on lending the valuable assets and reducing activity in the general collateral arena. Whatever the cause, the fall in the value of assets on loan has been outweighed by the rise in rates that have been charged. In a very basic comparison, this shows a rise in gross revenue of around 15 percent between the 2011 and 2012 dividend seasons, somewhat in line with what we hear anecdotally from our clients.

Looking at the data behind an individual security always leads to actionable information—even if that action is to not borrow or lend it. But opportunities abound if the data can be made to work for you. Looking at the tobacco sector for instance, we can see a collection of companies growing and expanding sales against the flow of many other sectors suffering in the global recession. They have done this through finding new, lucrative markets in Asia and the Middle East as markets closer to home mature.

Philip Morris (PM) is a globally recognised brand, and there is very little lending visible in its shares. Looking beneath the sector summary though, there is an outlier earning some very special rates—Star Scientific (CIGX) has attracted a negative rebate against USD consistently since September 2008 and has now reached below negative 30 percent rebate for more than a year (see Figure 2). Seeing such a divergence from the sector is a good example of actionable information, showing revenue opportunities for lenders and their clients, as well as borrowers and their clients. The key is, as ever, distilling vast quantities of data and creating something clear, digestible and above all, actionable. **SLT**

Figure 1: European equities

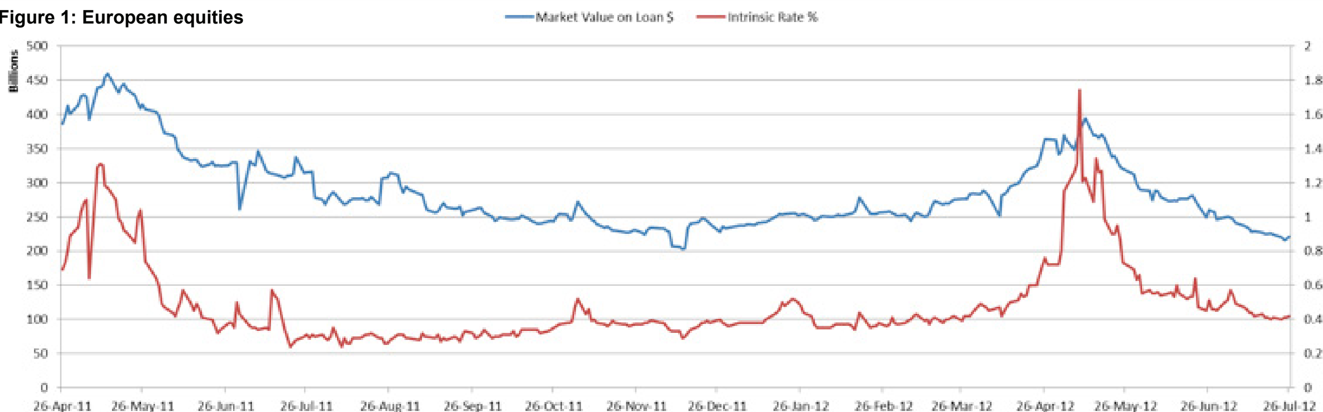

Figure 2: Star Scientific (CIGX)

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Industry appointments

It has been reported that **Neil Swinburne**, head of European securities lending trading at Citi's prime broking arm, has resigned.

Swinburne joined Citigroup in April 2006 from Goldman Sachs, where he was executive director in charge of securities lending trading.

He and Nick Roe were part of the top-level hires intended to boost Citi's European prime brokerage operation.

Roe left Deutsche Bank, where he was global head of prime services, to join Citi in October 2005 as European head of prime finance.

Rule Financial has recruited **James Tomkinson** as a domain specialist in OTC clearing and collateral management.

He joins the company from Citi, where he was a collateral management vice president in the global transaction services division. Before joining Citi, Tomkinson provided consultancy services at LCH.Clearnet and worked as director of repo products at Nomura International.

Tomkinson was also part of the team that developed the first European triparty repo product at Clearstream International.

In his new position, Tomkinson will consult and service clients that need to optimise collateral as a result of Basel III, US Dodd-Frank Act and European Market Infrastructure Regulation OTC reforms.

He will report to the head of Rule Financial's domain group, Jim Warburton.

It has been reported that **Elizabeth Hammond** has replaced Justin Fredericks at Bank of America Merrill Lynch.

Fredericks joined Bank of America in 2001 as head of capital introductions for the Americas. He led the bank's US capital introductions team, which is a part of its prime brokerage business, before reportedly departing to pursue other opportunities.

His replacement—Hammond—has already taken up the position and will be reporting to Michael Terry, who runs the bank's capital introduction programme globally.

Before joining Bank of America in 2009, she worked as a senior member of the capital introductions group in Citi's prime finance unit.

Bank of America's prime brokerage business has undergone significant changes. The bank sold its prime brokerage business to BNP Paribas in 2008, but it re-entered the market when it bought Merrill Lynch a few months later.

Stuart Hendel joined Bank of America in 2011 from UBS to become the head of its global prime brokerage group.

Since joining, Hendel has pursuaded **Charlotte Burkeman** (co-head of EMEA prime brokerage) and **Jonathan Yalmokas** (head of US prime brokerage) to move to Bank of America from UBS. He has also made other additions, including **Michael Terry**.

eSecLending has recruited **Peter Economou** as its CRO. Economou took up the newly created position on 6 August and is responsible for the oversight and strategic development of enterprise risk management on a global basis. He reports to CEOs Karen O'Connor and Chris Jaynes.

Economou, who has more than 25 years of experience in capital markets, balance sheet management and portfolio management, previously worked as an executive vice president and the global head of securities finance and portfolio solutions at State Street.

He held other senior positions within State Street's securities finance division, including global head of trading and risk management and global head of asset liability management.

He left State Street in 2010 for Premier Global Securities Lending, but he soon moved on to become a financial advisor at Morgan Stanley.

O'Connor said: "In recognition of the industry's advancement and increasing focus on risk management, this new role has been established to ensure eSecLending remains at the forefront of managing risk for our company and our clients."

"This appointment demonstrates our company's ongoing commitment to strengthen the breadth and depth of our team and we look forward to leveraging Economou's leadership experience and deep understanding of the industry to enhance our existing risk management practices."

Economou added: "With an alignment of client interests and a model that favours independence, transparency and discipline, eSecLending has demonstrated success in adapting to the industry's evolution by continuously developing risk adjusted solutions for their clients.

Andrew Amstutz has left Citi, where was the global head of funding for prime finance and equity in New York.

Before joining Citi, Amstutz was based in London. He worked at Morgan Stanley as the global head of institutional securities group funding in fixed income and equities. **SLT**

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Published by Black Knight Media Ltd
Provident House, 6-20 Burrell Row
Beckenham, BR3 1AT, UK

Company reg: 0719464

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