SLT SECURITIES**LENDING**TIMES

ISSUE059
04.09.2012 TUESDAY
securitieslendingtimes.com

European ETF securities lending revenue hit €40 million in 2011

LONDON 31.08.2012

A survey has found that approximately €40 million in net revenue was generated from securities lending in European physical replication exchange traded funds (ETFs) last year.

Information and data provider Morningstar's survey of 10 European providers of physical replication ETFs comes after the European Securities and Markets Authority (ESMA) released controversial guidelines on ETFs and other UCITS issues that affect securities lending in July.

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 techniques, such as securities lending, repo and reverse repo, that they may carry out.

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."

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J.P. Morgan sees first HKD triparty repo transaction

J.P. Morgan Worldwide Securities Services has executed Hong Kong's first HKD triparty repo transaction between Bank of China and Barclays.

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UBS makes quantitative leap

UBS has launched a new unit that is aimed at attracting and servicing clients among quantitative hedge funds.

read**more p2**

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European ETF securities lending revenue hit €40 million in 2011

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

In a recent statement, the International Securities Lending Association's chief executive, Kevin McNulty, said that the normal method of compensation for securities lending services is for an agent to charge a commission.

"In our opinion there is nothing in the guidance that precludes a securities lending agent, be that the fund manager, custodian or third party, from charging a commercial fee for their services. Such fees would be regarded as part of the direct and indirect costs which the guidelines state may be deducted from revenue."

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

In a report on the survey, Morningstar analysts and its authors, Hortense Bioy and Gordon Rose, said: "Revenue sharing arrangements vary greatly across providers. At present, securities lending fees returned to funds range from 45 percent to 70 percent of gross revenues, with the ETF issuer and/or the lending agent retaining the balance, part or all of which is used to cover operational costs. Meanwhile, a couple of providers simply say they return 100 percent of the revenues, net of costs."

The analysts said that there is "no guarantee" that more money will be returned to fund shareholders, adding that "they may only change the way they disclose their arrangements going forward".

"[They may state] that 100 percent of lending revenue is returned to the ETF, minus the fees paid to the fund manager and/or the lending agent, which may effectively be equivalent to the share of gross revenue they are retaining today. Thus, any changes to current practices made to comply with ESMA's new guidelines may be more a matter of semantics than economics."

"Ultimately, our hope is that the additional transparency required by the regulator will serve to drive down the costs associated with securities lending by allowing competitive pricing pressure to come to bear. This, in turn, will hopefully lead to enhanced fund performance."

J.P. Morgan sees first HKD triparty repo transaction

Continued from page 1

The bank and the Hong Kong Monetary Authority collaborated on a repo financing collateral management programme to facilitate repo financing transactions between members of Hong Kong's Central Moneymarkets Unit (CMU) and international financial institutions. The programme launched in June.

It allows CMU members to accept a broad spectrum of international securities that are lodged with J.P. Morgan and other securities depositories as collateral.

It also gives international financial institutions that enter into repo financing transactions with CMU members access to liquidity for offshore CNY, EUR, HKD and USD in Hong Kong.

J.P Morgan developed a collateral management platform to support the programme. The trade between Bank of China and Barclays is the first one to be executed since the programme's launch.

The trade "leveraged the cross-currency, cross-border and global capabilities of the repo financing programme and J.P. Morgan platforms by mobilising US Treasuries against HKD liquidity," said J.P. Morgan in a statement.

Kirit Bhatia, head of technical sales for Asia (excluding Japan) at J.P. Morgan Worldwide Securities Services, said: "This is an exciting milestone for Hong Kong as it points to the new opportunities for local and global firms seeking to participate more deeply in the region's rapidly developing capital markets. We look forward to playing a key role in the market's ongoing development."

UBS makes quantitative leap

Continued from page 1

Quant HQ combines the firm's prime services and direct execution businesses to provide quantitative traders with access to its global investment services.

It will reportedly support equities, options and futures strategies, and will target startups and established funds with long/short or hedged strategies, as well as those that are focused on arbitrage.

The unit will also use UBS's prime brokerage services to help funds raise capital from investors looking for quantitative strategies.

Former Saxis Group COO Scott Stickler will lead Quant HQ from New York. Dave Mishoe will head up Quant HQ in the Europe, Middle East and Africa region, while Steve Hammerton will do the same for the Asia Pacific region.

"We've consistently invested in creating a fast, innovative, highly scalable platform," said Mike Stewart, global head of equities at UBS. "Making that available in combination with our global market access, industry-leading capital position and deep expertise in enterprise formation, the goal of Quant HQ is to deliver a comprehensive set of solutions to quantitative trading clients."

Charlie Susi, global co-head of direct execution at UBS, said: "Quantitative traders are a highly sophisticated segment of the global securities markets, and a major source of market liquidity. They know precisely what they want from their service providers and have highly specialied needs. With Quant HQ, we've organised ourselves to empower them to implement their innovative models and help them quickly seize opportunities for alpha, wherever they trade."

China 'ready' to expand stock margin trading programme

The Shanghai and Shenzhen stock exchanges are set to expand their pilot securities margin trading programme on a trial basis, permitting brokerages to borrow money and stocks to relend to their clients.

China's first ever securities margin trading programme, which was launched by the exchanges in 2010, permitted brokerages and investors to use their own stocks as collateral to borrow money to conduct margin trading.

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Brokerages are now reportedly permitted to borrow money and stocks from banks, funds and insurers, and re-lend the money and stocks to their clients to conduct margin trading.

Chinese state media said that 11 brokerages from the existing programme have been selected to conduct the re-lending business.

Brokerages will begin with borrowing money for the re-lending business and expand it to borrowing stocks when they become more experienced in the activity, according to reports.

The China Securities Regulatory Commission is expected to give the green light to the programme soon.

Moody's: OTC regulations could lead to riskier investments

Funds could invest more heavily in collateral-eligible liquid, high-quality government securities when new OTC derivatives regulations take hold worldwide.

New OTC derivatives regulations are being implemented in Europe and the US, as well as other jurisdictions, in a bid to mitigate the risks that are associated with OTC transactions.

In May, regulators met in Toronto to discuss the implementation of regulations and iron out technical issues. Representatives of regulators from key markets, such as Europe, the US, Singapore, Hong Kong and Brazil, attended the meeting.

High on the agenda were pre- and post-trade transparency, margin for uncleared derivatives, coordination of clearing mandates, access to data in trade repositories, and cross border clearing house crisis management.

A joint statement from the participating regulators said: "The participants welcomed the opportunity for continued discussion and sharing of information on implementation of OTC derivatives reform, with a view to further align regulatory requirements where possible."

In a new report, Moody's said that while increased collateral requirements for derivatives transactions will lead to a sounder credit environment for the market as a whole, they could force some funds into riskier investments.

It said: "Lower yields on government securities resulting from their increased demand from regulatory requirements may lead to a shift in bond and money market fund allocations into riskier, lower credit-quality investments to seek higher yields."

It added that when regulations that require central clearing for standardised derivatives and global standards on margins for unclear trades come into effect before the end of 2012, they will cause demand for government securities to increase and exert downward pressure on yields, "which will lower returns for the funds that are mandated to invest in these securities".

"Moody's believes that the new regulations will exacerbate conditions that are already exerting pressure on yields, such as (i) government benchmark yields have fallen, some to negative territory, with a flight to quality; (ii) the supply of higher-rated investment-grade corporate, supranational and agency bonds remains limited; and (iii) the use of higher credit-quality corporate and agency bonds as eligible collateral is beginning to be seen in the market, although the level of usage remains low."

US SEC drops MMF proposals

Proposals intended to reform the multi-trillion dollar US money market fund (MMF) industry were dropped after three US SEC commissioners objected to them.

US SEC chairman Mary Schapiro said in a statement that shewanted to reform the MMF industry's structure so that retail investors could be protected and future taxpayer bailouts could be avoided.

MMFs showed structural weaknesses during the 2008 financial crisis, when they failed to absorb losses in the value of portfolio securities and withdrew hundreds of millions of dollars from prime money market funds, after running "at the first sign of a problem", according to Schapiro.

The reform proposals would have seen MMFs float the NAV and use mark-to-market valuation. Alternatively, they would have used a tailored capital buffer of less than 1 percent of fund assets, which could be adjusted to reflect the risk characteristics of an MMF.

But three US SEC commissioners have objected to the proposals, so they cannot be published for public comment and there will be no public vote on them.

In her statement, Schapiro said: "The issue is too important to investors, to our economy and to taxpayers to put our head in the sand and wish it away. Money market funds' susceptibility to runs needs to be addressed. Other policymakers now have clarity that the SEC will not act to issue a money market fund reform proposal and can take this into account in deciding what steps should be taken to address this issue."

The International Organization of Securities Commissions's (IOSCO's) chairman of the board, Masamichi Kono, issued a statement that did not comment on Schapiro's statement directly. But Kono did reaffirm IOSCO's commitment to developing policy recommendations for strengthening oversight and regulation of the shadow banking system, including MMFs.

Cantor Fitzgerald to launch new clearing service

Global financial services firm Cantor Fitzgerald plans to expand its clearing services in Q4 2012 with the launch of Cantor Clearing.

The new clearing operation is set to provide clearing, settlement and technology solutions for financial service firms, targeting clients including institutional and online broker dealers, registered investment advisors and other asset managers.

Cantor clearing will use SunGard's integrated suite of clearing and settlement solutions to help streamline front-to-back securities processing for clients.

SunGard's integrated features "will help drive efficiencies in transaction clearing and settlement, providing a cost-effective and competitive framework compared to alternative clearing solutions," said the firm in a recent statement.

Noel Kimmel, CEO of Cantor Clearing and head of Cantor Prime Services, said: "The formation of Cantor Clearing will complement

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"By leveraging existing in-house capabilities, our robust global infrastructure, cross-asset expertise and SunGard's technology, we will provide a comprehensive solution tailored to the needs of middle market clients. Cantor Clearing reflects our commitment to supporting the changing market landscape and evolving needs of our clients."

John Grimaldi, executive vice president of SunGard's North American securities operations and securities finance business, said: "SunGard's suite of clearing solutions is helping correspondent clearing businesses like Cantor Clearing increase efficiency and improve client service and retention."

"SunGard's real-time functionality allows customers to see positions and balances as they trade, enabling real-time transparency throughout the day. SunGard also supports multiple margin methodologies, helping Cantor Clearing to more effectively calculate and report relevant data to its correspondents and compete more effectively in a challenging industry."

LCH.Clearnet accepts gold as collateral

LCH.Clearnet began accepting unallocated gold as collateral for margin cover purposes on 28 August.

The expansion of LCH.Clearnet's existing collateral range is subject to criteria including daily valuation, with an initial haircut of 14 percent applied.

Earlier this year, LCH.Clearnet began accepting Ginnie Mae mortgage-backed securities (GNMA MBS) to widen its range of existing collateral types.

Accepting new collateral types such as GNMA MBS is an aim of LCH.Clearnet's collateral and liquidity management (CaLM) group. It wants to offer clients a more efficient, centralised collateral management service.

In a recent statement, Andrew Howat, head of CaLM at LCH.Clearnet, said: "This addition to our range of acceptable collateral reinforces our strategy to maintain the highest standards of risk management, whilst demonstrating our ongoing commitment to developing our business offering, both in the US, and for our buy side clients."

4sight releases new collateral management interface

Software and consultancy firm 4sight Financial Software has developed an interface between Germany-based Clearstream Banking's KAGplus collateral management service and its 4sight securities borrowing and lending software solution.

The German Investment Act prevents German funds from lending more than 10 percent of their assets unless they trade through the KAGplus platform. The platform pools and allocates pledged collateral for each participating fund "while following sound risk management principles", according to 4sight.

4sight developed the new interface as part of a wider project to implement its 4sight securities

MXCorner

Here comes the fun

As I write this, I suspect that everyone is returning from their summer holidays, and having enjoyed the barmy summer weather, will be thinking about what needs to be done before the end of the year. With so much regulatory change happening it's going to be a busy quarter.

The short selling regulation in Europe comes in to effect on 1 November and it is still not completely clear how this will affect the industry. As a minimum, borrowers need to be able to identify securities that are defined as liquid and illiquid (which may have no relationship to genuine liquidity in the securities finance markets) and have appropriate procedures in place to manage each type. Lenders need to be assured of recall procedures to avoid inadvertent short sales on client accounts and be prepared for a potentially significant increase in the number of daily holds that they will need to manage. With approximately six to eight weeks left before implementation businesses should be fairly clear by now on how they will manage this.

The UCITS guidelines that were published by European Securities and Markets Authority in late July will come into force early next year, so preparation is required in this quarter. While a lot of press coverage (unnecessarily in my opinion) has focused on the definition of fee sharing arrangements, there are still some genuine uncertainties around interpretation and whether the new guidelines will restrict collateral management arrangements as well as effectively restrict the amount of lending that these funds can do. Again, lenders need to be aware of these guidelines and look at the changes that are required to ensure compliance, while keeping in mind that the European Commission is also now looking at this space and UCITS V is around the corner, so further changes may be afoot.

Then, of course, there is the Financial Stability Board's (FSB's) report on shadow banking, which is due for publication in this quarter. The industry has been working with the FSB to try and ensure that any proposals achieve their objectives while being proportionate and workable for the industry. Nevertheless, what these proposals will look like remains to be seen, but there is no doubt that whatever they say, further changes in controls and procedures will be required.

Finally, there is the somewhat bigger changes that may not have any effect in this quarter, but do need to be kept in mind for 2013 planning and budgeting. Changes include Basel III, liquidity reporting, and of course, Solvency II, all of which may need significant IT solutions to deliver compliance and so will need to be planned for and considered more strategically.

Sarah Nicholson, senior partner
MX Consulting Services

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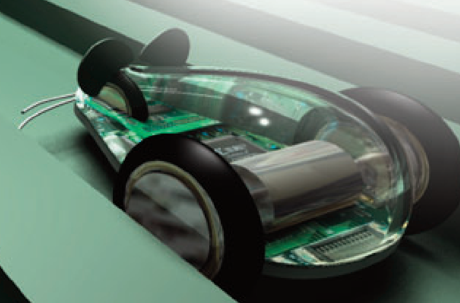

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finance system for a European bank. The bank needed an interface that would allow it to communicate securities lending trades that are booked in 4sight's securities finance solution to KAGplus.

When initiating a KAGplus-enabled borrow, the new interface enables 4sight's system to automatically send a SWIFT message to Clearstream, so that the trade can be registered with KAGplus.

A borrow will remain blocked until Clearstream confirms with KAGplus that its position has been validated. The interface can warn a user about a negative outcome—if a borrow fails to register in KAGplus due to insufficient availability, for example—with alerts.

Martin Seagroatt, 4sight's head of marketing, said: "The new interface will enable users of 4sight's securities finance and collateral management system and the KAGplus service to increase straight through processing of trades and automate trade lifecycle management. This latest interface increases the integration options offered by 4sight securities finance as we leverage the connectivity we offer with third party solutions and service providers."

CME Clearing Europe collateral types to include gold bullion

London-based clearing house CME Clearing Europe, a wholly owned subsidiary of CME Group, now accepts gold bullion as an eligible form of collateral in a move hoped to foster growth of derivative trading volumes.

The newly approved payment form comes at a time when "high quality collateral is at a premium" and clearing of OTC derivatives is "increasing", said the CME Group.

Andrew Lamb, CEO of CME Clearing Europe, said: "We recognise there will be a massive demand for collateral as a result of the clearing mandate. This is part of our attempt to maintain the risk management standard and to offer greater flexibility to clearing members and end clients."

Following in the footsteps of CME Clearing, which has accepted gold as collateral since late 2009, CME Clearing Europe said that the additional flexibility that is provided will cover margin requirements.

CME Clearing Europe currently clears OTC commodity derivatives and plans to introduce OTC interest rate swap clearing once it receives regulatory approval.

The new service to be launched later this year is set to "offer clearing for interest rate swaps, with systems and processes developed in close collaboration with swap dealers, clearing firms and buy-side users", said CME Clearing Europe.

On top of interest rate swaps, CME Clearing Europe is also planning to add to its range of financial derivative products that are available for clearing with new services for credit default swaps and foreign exchange.

Nigeria names securities lending agents

The Nigeria Securities & Exchange Commission has approved United Bank of Africa (UBA) and Stanbic IBTC as securities lending agents for equities and bond transactions at the Nigeria Stock Exchange, according to reports.

The exchange relaxed restrictions on short selling in May, allowing stock price movement of up to 10 percent per day and introducing market makers to borrow stocks for shorting.

Speaking at the time, Ade Bajomo, executive director of market operations and technology at the exchange, said: "What would we like to be when we grow up? I think Singapore. A market that rises up from almost zero, a market run in an efficient manner ... a financial hub. One of the key initiatives is market making, securities lending and short selling. We want to build a hybrid market, with market-makers to create liquidity."

Approval of the two securities lending agents reportedly followed a review of applications from five banks, and UBA and Stanbic came out on top.

The commission is also scrutinising market-making rules before implementing them, while the exchange designated Stanbic, Renaissance Capital, Future View Securities, Vetiva Capital and ESS/DunnLoren Merrifield as market makers in April.

Oscar Onyema, CEO of the exchange, said of the designations: "This is a great milestone and a major step in the direction of turning the market round to have liquidity and depth back into the market. We will continue to move forward on this."

"The companies selected went through a very rigorous process and met the minimum net capital requirement of N570 million. We also examined their compliance history and looked into their operational capabilities including their technology and processes. The selected firms were taken through trainings, debated the appropriate market structure to be used and the exchange further went through the approval of the Securities and Exchange Commission in the selection process."

Pension fund separates securities lending from custody

Deutsche Bank has replaced State Street as Texas Municipal Retirement System's securities lending agent.

The pension fund, which reportedly has assets of $19.5 billion, oversaw 141,532 accounts for US State of Texas employees from 847 cities in 2011.

State Street acted as the global custodian and securities lending agent for Texas Municipal Retirement System, and reportedly rebid for the roles when the pension fund put them up for tender. But it was only rehired as the Texas Municipal Retirement System's global custodian, losing out to Deutsche Bank for the securities lending agent mandate.

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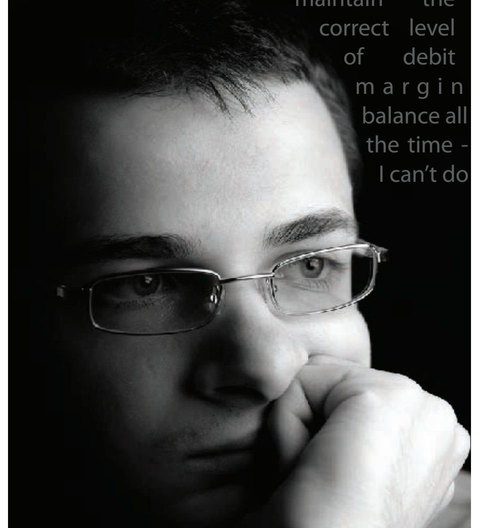

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Welcome to Malaysia

Although it is not the biggest country in Asia, it does mean business, as SLT finds out

MARK DUGDALE REPORTS

The Asia Pacific region is continuing to prove its worth as a source of emerging securities lending markets, despite concerns over slow economic growth.

In South East Asia, Malaysia's economy is suffering from "external headwinds, especially from the West", according to audit firm Deloitte's August 2012 economic outlook on the country. It said that export revenues are likely to suffer from subdued commodity prices, but Malaysian exports rebounded in May due to stronger import demand from Singapore, China and Japan.

Deloitte added: "While a fall in export revenues will likely weigh on growth this year, domestic demand will drive modest expansion. The Malaysian economy is expected to expand by a little over 4.5 percent in 2012, slower than 5.1 percent expansion recorded last year."

In its Q2 2012 securities lending market update, RBC Investor Services's desk head for Asia Pacific trading, Trevor Amoils, said that "while the underlying global economic concerns continue, returns in Asia Pacific remain relatively robust".

Malaysia has recently shown signs of this. J.P. Morgan Worldwide Securities Services, which already provided securities lending services in Australia, Hong Kong, Japan, New Zealand, Singapore, South Korea, Taiwan and Thailand, rolled out its securities lending services in Malaysia in June. This made J.P. Morgan the first international lender in the Malaysian market to offer a securities lending product.

J.P. Morgan said that it planned to offer securities lending solutions to prime brokers and clients with Malaysian assets, "with asset managers and institutional investors benefiting from improved risk-adjusted returns on their securities portfolios containing Malaysian assets".

Speaking at the time, Shaun Parkes, CEO for Asia (excluding Japan and Australia) at J.P. Morgan Worldwide Securities Services, said: "The future for securities lending in Asia Pacific continues to demonstrate significant potential. Malaysia represents an important part of our regional growth strategy, and is a key value-add for our institutional client base that is looking to diversify their investments and mitigate their risk."

Shariah-compliant assets

Malaysia is a major centre for Sharia-compliant assets, making it an attractive destination for Muslim investors.

According to Diana Senanayake, managing director at RBC Investor Services Singapore, Malaysia is the "most important market for Shariah-compliant asset management in Asia and is generally considered to be the most sophisticated environment for Islamic finance in the world".

In an August 2012 market update, Senanayake said that Islamic funds that are registered in Malaysia total $5.1 billion, adding that "despite having the most Shariah-compliant funds in the world it is, however, second to Saudi Arabia in terms of AUM".

Muslim investors traditionally avoid participating in activities such as short selling and investing in certain types of funds due to Sharia law. Senanayake said: "Sharia law forbids short selling because it involves the sale of something that is not owned, so Muslim investors have traditionally frowned on hedge funds because they adopt strategies that are considered forbidden under Sharia."

Sharia law also prohibits investment in unlawful (haram) items, including entities with primary business related to alcohol, tobacco, pork, gambling products, and weapons and arms.

Limits that are placed on foreign assets are likely to increase in Malaysia "as new regulations come into effect and new foreign asset management companies enter the market", said Senanayake.

"This will serve to increase the interest in Islamic funds in Malaysia and widen the participation of Arab investors in the world's financial markets."

Equity funds are the most common type of Islamic fund and they are invested in the shares of companies. "Returns to investors are in the form of capital gains and dividends," said Senanayake.

Other types of funds include Ijara funds (a lease, rent or wage), commodity funds, Murabaha (a type of fiduciary sale) and mixed funds.

On mixed funds, Senanayake said: "The subscription amounts of mixed funds are used in different types of investments, including equities, leasing and commodities. Real estate funds can use proceeds to invest in buildings and real estate. Any income is distributed among the certificate holders as dividends/capital gains."

"Secondary trading depends upon the nature of the underlying asset. Stocks, certificates and sukuk can be traded in the market subject to compliance with Sharia rules. Instruments representing real physical assets and usufructs are negotiable at market price. Stocks, units, certificates or sukuk, issued on the basis of musharakah (a joint venture), mudarabah (a profit sharing contract) and ijara fall within this category."

Malaysia is an emerging jurisdiction with its doors open to both the East and the West. A multicultural welcoming of this sort has done wonders for the UK and London, and Malaysia is a part of a group of countries that are at least enjoying growth at the moment, even if is not as high as expected. **SLT**

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The managed care industry's Olympic challenge

Andrew Shinn of SunGard Astec Analytics assesses the likely impact of the Patient Protection and Affordable Care Act on the managed care industry in the US

HEALTH DATA

The 2012 London Olympic opening ceremony organisers may have confused some viewers with their celebration of the UK National Health Service, but they should be commended for putting the healthcare industry in the spotlight, for it plays a critical role in many countries' economies. For example, the US continues to spend more of its resources on medical care (roughly 18 percent of GDP in 2010), and 80 percent of total medical care spending is incurred by just 20 percent of the US population, many of whom are suffering from chronic diseases.

Before London hosted the Olympics this summer, the US Supreme Court had its own showdown when it decided whether to uphold the Patient Protection and Affordable Care Act (ACA). President Barack Obama signed the ACA into law on 23 March 2010, and it will have a significant effect on managed care organisations, such as UnitedHealth, WellPoint and Aetna.

The current US healthcare system is inefficient in part because it is not market-based. Otherwise savvy consumers do not behave the same way when they are patients. In fact, many patients are not even aware of how much they are spending on care because for the majority of Americans, care is financed through the US government or employer-sponsored insurance. Furthermore, doctors and hospitals are often paid by how many treatments and tests they order rather than patient health outcomes. And because there is insufficient cost-sharing, patients agree to these tests because they will only have to pay out-of-pocket for a small proportion of the total cost.

The system is also too focused on the short term. For instance, an expensive drug or treatment that may be cost effective for a patient over the long term will usually be denied by an insurance company that is uncertain whether the long-term benefits will accrue to it or a competitor.

Instead of focusing on reducing medical cost inflation, however, the main goal of the ACA is to increase insurance coverage for 32 million uninsured Americans, half through an expansion of Medicaid and half through government-subsidised insurance exchanges. The law also mandates guaranteed issuance, which requires managed care companies to issue coverage to everyone, and community rating, which requires companies to charge healthy and sick individuals of the same age the same rate.

While managed care companies in the past were frequently vilified for refusing to issue coverage to sick people at an affordable rate, the companies were only responding to a market in which prospective subscribers each had a different risk profile and could choose to enroll in a health plan after getting sick. To help reduce these problems, the ACA requires almost all Americans to obtain insurance or else pay a tax; and with short open enrollment periods, individuals will find it difficult to game the system by waiting until after becoming sick to sign up for insurance.

In addition to its effect on millions of uninsured Americans, the ACA will also have a sizeable effect on the managed care industry. However, investors may be overreacting to ACA, and the currently low share price multiples may offer investors more long than short opportunities. Essentially, for every aspect of the ACA that is detrimental to managed care companies, Democratic lawmakers ensured that there was an equally off-setting positive. Lack of buy-in from the managed care industry helped to kill former President Bill Clinton's health reform bill in the 1990s, and Democrats were careful not to make the same mistake with the ACA.

The negative effects on the managed care industry include an annual fee that starts at $8 billion in 2014 and rises to $14 billion in 2018 and thereafter. In addition, the ACA will cap managed care companies' gross profits with minimum "medical loss ratios" (MLRs). MLRs are the proportion of premiums that are paid out as medical benefits. If a managed care company does not provide sufficient benefits to its members, it will be required to rebate back the difference. Large and small health plans' gross margins will be capped at 15 percent and 20 percent, respectively.

Managed care companies in the commercial space are likely to simply pass on the fee to members in the form of higher premiums. Managed Medicare and managed Medicaid plans will have a more difficult time

passing on the fee, but to further offset the fees, the ACA will award bonus payments to health plans that achieve a sufficient ranking in the new Star Rating system. And instead of requiring managed care companies to achieve a four-star ranking, standards were lowered to include plans that achieve just three stars. Also, the MLR calculation methodology builds in a buffer that is favourable to the industry, so GAAP gross margins will be 500 basis points larger than corresponding MLRs. Managed care companies will also be able to pass off more administrative costs to doctors and hospitals and include those costs as medical care.

Short selling opportunities will result as significant parts of the ACA are implemented in 2014, specifically the state-based exchanges on which individuals and small groups may purchase health insurance. For instance, WellPoint and Aetna will lose their individual and small group business to the new insurance exchanges in 2014. Profit margins will decline from the high single digits to the low single digits.

The crucial questions are which managed care companies will win on the new exchanges and what percentage of the medium and large group market will also transition to the exchanges. UnitedHealth and WellPoint are well positioned to be winners on the exchanges, but Aetna is not as favourably positioned because it has less local market share in any one region. Both WellPoint and Aetna generate roughly 20 percent of revenue and earnings from the individual and small group market. While WellPoint's margins will definitely decline, it may still maintain or increase market share on the exchanges. But if Aetna is not able to maintain market share, it will take a double hit on both revenue and earnings.

On the other hand, there are growth opportunities, specifically in the managed Medicaid market. Firstly, the expansion of Medicaid to another 16 million people as part of the ACA will create tens of billions of dollars in additional revenue. Also, states are increasingly turning to managed Medicaid to reduce rising Medicaid costs, and this will result in roughly $15 billion of additional revenue. Finally, ACA has created a new office in charge of transitioning "dual eligibles" onto managed care plans. Dual eligibles are the nine million Americans who are covered by both Medicare and Medicaid, and they collectively spend $300 billion on medical care annually. While managed care companies would be expected to reduce this annual cost with better disease and utilisation management, the increased revenue to the industry should still be north of $100 billion.

The growth opportunities in managed Medicaid have already led to recent acquisitions, such as WellPoint's purchase of Amerigroup, which was announced in July, as well as Aetna's acquisition of Coventry, which was announced in August. Centene was another potential acquisition target as it generates almost all of its revenue from managed Medicaid, but investors may believe that it may have difficulty competing against WellPoint/Amerigroup and Aetna/Coventry in that space. Centene is the only managed care company with more than 10 percent of its float borrowed and sold short.

The managed care industry will be interesting to watch over the next few years as it goes through significant change as a result of the ACA implementation. Furthermore, with US Republican presidential candidate Mitt Romney's selection of Paul Ryan as the Republican vice-presidential candidate, the debate surrounding Medicare and Medicaid reform, and health reform in general, will only get more intense.

The ACA's far-reaching impact on one of the largest sectors of the US economy is also important to understand because aspects of American-style managed care organisations are now part of the debate in the UK in relation to the Secretary of State for Health Andrew Lansley's recent Health and Social Care Act. Almost all developed countries are struggling to balance rising medical care costs with ensuring access to healthcare for the greatest number of their citizens, so American-style managed care best practices will likely continue to rise in prominence in many countries outside of the US. **SLT**

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Industry appointments

Timothy Douglas, formerly the head of securities finance at Citi, is moving into a different role within the corporation.

A spokesperson confirmed that Douglas, who was based in New York, will remain in the state, but will be taking on a more institutional role.

Currently Citi is looking both internally and externally for a replacement, with Douglas' responsibilities in the interim being taken over by Neeraj Sahai, global head of securities and fund services.

Brian Staunton has been hired by Union Bancaire Privée as a consultant.

Staunton was previously the head of securities finance at Citi. He joined the bank in October 2004 as European product manager responsible for the securities finance business in EMEA.

Between 1997 and 2004 he worked for Deutsche Borsche Group in London, formerly Clearstream Banking, where he was head of the UK, Ireland and Scandinavia for custody, clearing, securities lending and tri-party repo.

Rule Financial has recruited **Marina Potok**, a specialist in OTC, structured and securitised products for its domain group.

She will report to Rule Financial's domain group head, Jim Warburton, and will be based in its London office.

Before joining Rule Financial, Potok worked at UBS as executive director and the global head of structured rates for the middle office.

Concept Capital Markets has appointed **Kyle Kupiec** as a managing director in its prime brokerage services group.

Kupiec's was a principle at Shoreline Trading Group, where he helped to build the firm into a reputable broker-dealer. Adrienne Franklin, **Dennis Huynh** and **Richard de Ande** join Kupiec, who will be based in Los Angeles and act as the office's manager, at Concept Capital from Shoreline Trading, where they were a part of his team.

Kupiec's clients are also making the move with him. Their accounts will remain in custody at the same clearing firm and they will continue to use the same trade execution systems.

BNY Mellon has made a number of key senior management appointments in its German office.

Thomas Brand has been appointed head of investment services for BNY Mellon in Germany. In this new role, Brand will be responsible for relationship management and business development across Germany, Switzerland and Central and South East Europe.

On top of this, Brand has been made a branch manager of the Bank of New York Mellon SA/NV branch management business and he has joined the supervisory board of BNY Mellon's KAG business. Brand has previously worked as country executive for Germany and regional executive for the German speaking Central and South East Europe regions.

Jürgen Frank has become chairman of the supervisory board of the KAG business. Along with this new role also comes confirmation of Frank's extended contract as branch manager and spokesman for the Frankfurt branch of the Bank of New York Mellon, as well as head of integration for the asset servicing business in Germany. Frank was formerly CEO of BHF Asset Servicing, which was acquired by BNY Mellon, bringing 30 years experience in the German financial services arena to his newly expanded role.

Joining BNY Mellon in October of this year will be **Laura Ahto** as head of asset servicing operations and service delivery in Frankfurt. In addition to this, Ahto will be appointed as branch manager in the Bank of New York Mellon's branch management business. Ahto joins BNY Mellon from London-based company Baring Asset Management, where she is deputy COO and head of operations and technology.

Christian Altmeyer has also been appointed as a branch manager in the Bank of New York Mellon's branch management business. He will be responsible for legal, regulatory affairs, internal audit and risk and compliance.

In his role as managing director and head of BNY Mellon legal in Frankfurt, he has experience in the areas of custody, collateral management, derivatives clearing, investment law and regulation.

BNY Mellon has also announced that managing director of BNY Mellon asset servicing, **Michelle Grundmann**, will be relinquishing her current responsibilities in the coming weeks prior to leaving the company to pursue a new role in the industry. **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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