SLT
SECURITIESLENDINGTIMES

ISSUE063
30.10.2012 TUESDAY
securitieslendingtimes.com

Spain extends ban on short selling as 1 November implementation looms

MADRID 29.10.2012

Spain's financial securities markets regulator the Comisión Nacional del Mercado de Valores (CNMV) has decided to extend a ban on short selling for an additional week and has submitted a proposal to the European Securities and Markets Authority (ESMA) to impose a further three-month ban effective from 1 November 2012.

The additional seven-day ban is an extension of the CNMV's previous three-month ban, which it introduced on 23 July to stabilise the volatility of the Spanish market.

Spain's short selling extension is in part due to the ongoing structuring process of the Spanish financial sector to cover capital needs.

The process, which was outlined in the 23 July Memorandum of Understanding (MoU) between the European Commission, the Kingdom of Spain and the Bank of Spain, has not yet concluded, and uncertainties could still affect Spanish financial stability.

"Raising the ban on short sales would heighten uncertainty through its likely impact on the market. Conclusion of this process is considered to be absolutely necessary to ensure the stability of the financial system and the Spanish capital market."

"Moreover, a number of events or circumstances that led to the adoption of the July decision and which may threaten the integrity of the Spanish financial markets are currently persisting," said a statement from the regulator.

readmore p2

SLTINBRIEF

Latest news
Researchers say that flash crash reforms may fail to avert another market meltdown
p3

Latest news
A Southern California pension plan fails to make its securities lending lawsuit against BNY Mellon a class action one
p5

Financial stability
The Bank of England's Che Sidanius talks about the central bank's paper on OTC derivatives reform
p9

Emerging complex
Poland continues to beat but not buck economic trends in Europe
p11

Regulatory insight
Impending US regulations could cause problems for securities lending. Experts consider the need for revisions and rule convergence
p13

People moves
RBC Investor Services promotes Foley, CalPERS hires new CFO, and more
p19

Pension fund picks Northern Trust for securities lending

The Merseyside Pension Fund has appointed Northern Trust to provide global custody, investment accounting, securities lending and commission recapture services for approximately £4.5 billion in pension fund assets.

readmore p2

Clearstream and HKMA to jointly launch collateral services

Clearstream and the Hong Kong Monetary Authority (HKMA) plan to provide cross-border collateral management and liquidity services in Hong Kong. They will launch the services in Q1 2013.

readmore p2

eSecLending
SECURITIES FINANCE TRUST COMPANY

United States +1.617.204.4500
Europe +44 (0) 207.469.6000
Asia Pacific +61 (0)2 9220.3610
info@eseclending.com
www.eseclending.com

Differentiated Lending Process:
Disciplined, Transparent, Repeatable

Securities Finance Trust Company, an eSecLending company, and/or eSecLending (Europe) Ltd., authorised and regulated by the Financial Services Authority, performs all regulated business activities. eSecLending (Asia Pacific) - ABN 16 134 096 147, AFS Licence 333334, is an office of Securities Finance Trust Company (incorporated in Maryland, U.S.A.), the liability of the members is limited.

Spain extends ban on short selling as 1 November implementation looms

Continued from page 1

The Italian Securities and Exchange Commission lifted Italy's short selling ban, which was also introduced in July, on September 14.

On 24 July, Greece's Capital Market Commission extended its short-selling ban, which has been in place since August 2011, to 31 October 2012.

To help authorities, investors and other market participants better understand the new short selling regulations coming into effect in Europe on 1 November, ESMA has released an informative question and answer document.

"The objectives of this short selling legislative framework are to increase transparency of short positions held by investors in certain EU securities, reduce settlement and other risks linked with uncovered or naked short selling and create a harmonised framework for coordinated action at European level," stated the ESMA document.

ESMA's regulation document provides responses to questions from financial industries and offers clarity on the requirements that will be introduced under the short selling framework.

Subjects covered in the paper include transparency and calculating net short positions, uncovering short sales and enforcement of the framework.

The document will be continually updated as new queries arise.

Pension fund picks Northern Trust for securities lending

Continued from page 1

This latest appointment brings Northern Trust's total assets under custody for LGPS to £65 billion. It demonstrates Northern Trust's continued commitment to developing tailored asset servicing solutions to support pension funds' unique requirements.

"Northern Trust's ability to customise their asset servicing reporting capabilities to meet our requirements, combined with their proven track record in the LGPS market were key factors in their appointment," said Peter Wallach, head of Merseyside Pension Fund. "In particular the ability to provide a single platform for reporting and managing all our assets should enable us to save time and resource."

Douglas Gee, head of business development for the UK and Ireland in Northern Trust's institutional investor group, said: "We understand that local government pension schemes clients face a unique set of challenges and have developed a number of solutions to support them, through our institutional governance services group, which can provide a tailored and highly focused level of information to help pension funds meet their regulatory requirements."

Clearstream and HKMA to jointly launch collateral services

Continued from page 1

Clearstream's partnership with the HKMA will allow "international financial institutions (as a collateral giver) ... to use their extended pool of collaterals in Clearstream to conduct repo transactions with and obtain liquidity from members (as a collateral receiver) of the HKMA's Central Money Markets Unit (CMU)," said a statement from Clearstream.

The services will also support Clearstream's Global Liquidity Hub customers in enhancing the utilisation of their collateral on an optimised basis.

Peter Pang, deputy chief executive of the HKMA, said: "We welcome Clearstream in joining forces with the HKMA and other global triparty repo systems in providing the cross-border collateral management services at the global and domestic levels. The expanded coverage of the cross-border collateral management services will further promote the development of a cost effective and efficient repo market in Hong Kong and enhance financial stability through the wider use of collateral to reduce credit risk among financial institutions."

Jeffrey Tessler, CEO of Clearstream, said: "We are pleased to partner with the HKMA and to be developing this additional access to liquidity in Hong Kong. The cooperation leverages our extensive experience in Asia, where we have been present and active for more than 20 years, and enables Hong Kong institutions to take advantage of our award-winning collateral management and triparty repo services, offered through our Global Liquidity Hub."

Aetna opts for OpenLend

Healthcare benefit company Aetna has selected Citi's OpenLend platform to provide it with securities lending services.

Openlend, which is part of a suite of investment services that are delivered through Citi OpenInvestor, provides open-architecture securities lending solutions to help clients achieve their performance objectives.

David Martocci, head of securities finance, securities and fund services at Citi, said: "We are pleased that Aetna recognised the value of our third-party securities lending expertise and our commitment to providing exceptional client service. The success of our OpenLend product is centered around providing customised solutions for our clients. We look forward to helping Aetna with its securities lending programme."

PrimeOne releases SwapCloud

PrimeOne Solutions has launched multi asset class swap system SwapCloud, which covers equities, converts, corporates, sovereign debt, futures, participatory notes, and American depository receipts.

SwapCloud is designed to consolidate swaps across multiple prime brokers and provide the foundation for all swap trading activities, including regulatory reporting infrastructure for the US Dodd-Frank Act, the HIRE Act and the Foreign Account Tax Compliance Act.

PrimeOne Solutions deploys SwapCloud. The system is live with clients across Asia, Europe and North America.

Make complex simple.

PIRUM

For every complex problem there is a clear route

In the complex regulatory landscape, Pirum's CCP gateway provides a direct route to capital efficiency.

www.pirum.com | sales@pirum.com

"We are excited to be the first provider to deliver a swap application to the buy side," said EJ Liotta, global head of PrimeOne Solutions. "We believe the market is ready to enhance its level of operational controls and implement a robust and scalable technology strategy that addresses the regional complexities of the swap markets."

"The uniqueness of the product, coupled with the cloud-based deployment model, fits well in an environment where firms are looking for a safe and speedy response to global regulatory demands, while seeking the lowest cost of technology ownership."

PrimeOne Solutions launched in September, taking on Scotiabank as a client. It provides the bank with end-to-end prime finance capabilities and services its prime services clients in the US marketplace.

The firm recently released SynPrime, an equity swap platform that provides investment banks and hedge funds with all aspects of managing and valuing synthetic trading activities, including financing capabilities, profit and loss, dividend workflows, resets and commissions.

State Street experiences 'seasonal' securities finance dip

State Street's Q3 2012 results revealed securities finance revenue of $91 million, a decline of 36.4 percent from Q2 2012. But revenue was higher than it was in the same quarter in 2011.

This drop was attributed to "second-quarter seasonality". Compared to Q3 2011, securities finance revenue increased 7.1 percent due to higher spreads, offset partially by lower volumes.

Outside of securities finance, net gains from sales of available-for-sale securities of $24 million were recorded in Q3 2012, and separately, $6 million of net losses from other-than-temporary impairment were recorded, resulting in $18 million of net gains related to investment securities.

Overall revenue for the firm was $2.36 billion, a decrease of 3 percent from $2.42 billion and $2.43 billion in Q2 2012 and Q3 2011.

Net interest revenue of $619 million decreased 8 percent from $672 million in Q2 2012 and increased 7 percent from $578 million in Q3 2011.

GAAP results included a net post-tax benefit of $166 million, composed of a $362 million benefit related to claims associated with the 2008 Lehman Brothers bankruptcy; partially offset by a $60 million provision for previously disclosed litigation arising out of asset management and securities lending businesses.

Joseph Hooley, State Street's chairman, president and CEO, said that the results reflected continued resilience across both asset servicing and asset management, which was partially offset by weakness in trading services.

"Although equity markets have improved, clients remain conservative in their investment allocations which adversely affects our revenue. We continue to see demand for our solutions as evidenced by new asset servicing wins, and net new assets of $78 billion to be managed by State Street Global Advisors and a strong pipeline."

"We look forward to integrating the recently closed acquisition of the Goldman Sachs Administration Services business and introducing these clients to our broad range of products and services. While acquisitions are consistent with our long-term growth strategy, one of our highest priorities in the current environment is returning capital to our shareholders."

Flash crash reforms may not be enough to improve system

Researchers have claimed that US 'flash crash' reforms will fail to avert another market meltdown unless they are coupled with new liquidity-based circuit breakers.

Academics Dr Giovanni Cespa of Cass Business School, City University London, and Thierry Foucault of HEC School of Management in Paris, have studied the May 2010 crash, which saw stock prices plummet and recover within minutes.

In their new paper, Illiquidity Contagion and Liquidity Crashes, they argued that high frequency trading has made markets become progressively intertwined, meaning that liquidity suppliers in one asset class increasingly rely on the prices of other asset classes to set their quotes.

This creates a self-reinforcing positive relationship between price informativeness and liquidity that can result in different market 'regimes' displaying inverted correlations between the two, according to the authors of the paper.

"Markets can therefore hover in different liquidity states for the same set of underlying fundamentals. This means that for a given underlying, the market can be in a high or a low illiquidity regime," said Cespa.

"In the former state [high illiquidity / low price informativeness], aggregate order realisations due to temporary price pressures trigger huge price adjustments. In the latter [high price informativeness / low illiquidity], the same realisations command milder price movements. Thus, the price impact of orders of a certain size is not univocally determined. Within this framework, a switch from the low to the high illiquidity equilibrium is what causes a flash crash."

The limit-up / limit-down circuit breaker system coming into force in the US in 2013 may not prevent future flash crashes.

In the paper, authors argued that illiquidity-based circuit breakers should be introduced alongside price-based circuit breakers to stop trading when market-wide depth falls below a specified threshold.

"This liquidity evaporation may materialise in one market first, triggering a spiral that drags all assets into the illiquid regime," said Cespa. "Price based circuit breakers do not necessarily offer a good protection against such illiquidity spirals because the latter may happen without trades and therefore without changes in prices."

www.mxcs.co.uk | contact@mxcs.co.uk

MXConsulting

A business & IT consultancy dedicated to the Securities Financing Industry

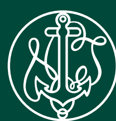
Delivering solutions to clients within Agent Lending, Custodial and Principal Securities Financing programmes

Positive Change, Efficiently Delivered

Experts in:

- ☐ Securities Lending
- ☐ Cash Management
- ☐ Risk Management
- ☐ Client Servicing
- ☑ All of the above

You want to focus on your strategic priorities. You need experts anticipating your needs and developing the tools to make you successful. For your securities lending business, rely on Northern Trust's unique global integration, exceptional capital strength and time-tested risk management. So you can concentrate on running ***your*** business. To find out more, visit northerntrust.com/securitieslending or call George Trapp at +1 312 444 3126 or Sunil Daswani at +44 (0)20 7982 3850.


Northern Trust

Asset Servicing | Asset Management | Wealth Management

© 2011 Northern Trust Corporation, 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. Incorporated with limited liability in the United States.

"[Illiquidity-based circuit breakers] could be an effective way to block an illiquidity spiral at its inception and thereby help traders to re-coordinate on a regime with higher liquidity."

The paper also looks to explain the performance of exchange-traded funds (ETFs) during the flash crash. The authors found that exchanges successively broke all of the transactions that occurred with a price drop in excess of 60 percent during the crash. ETFs accounted for nearly 70 percent of the securities that were involved in those transactions.

Cespa explained: "The fact that the market can hover into two liquidity states has implications for the ability of cross-market arbitrageurs to provide liquidity."

"Indeed, cross-market arbitrageurs diversify the risk associated with their position in one asset by taking an offsetting position in another (correlated) asset. As specialised dealers are the counterparties to this offsetting trade, liquidity provision by cross-market arbitrageurs rests on liquidity provision by specialised dealers."

"As a liquidity crash is characterised by a drastic reduction in specialised dealers' liquidity supply, it leads cross-market arbitrageurs to curtail their liquidity provision as well. This can explain the severe price disruption in the ETFs market, as well as why the dispersion of price differentials between assets can increase considerably during a liquidity crash, leading to the perception of major price dislocations."

Markit develops new add-on for Factor platform

Markit has released a new enhancement to Markit Data Analytics & Research's Factor product that tracks short selling sentiment.

The Factor analytics platform is a fully-integrated research and signal management platform that allows seamless custom model building and strategy deployment for equity and fixed income.

Investment professionals, including quantitative analysts, use it to evaluate signals when making investment decisions and managing risks.

The new Short Sentiment Factors Suite joins a suite of 300+ equity factors and 70+ credit factors. Markit Data Analytics and Research, which was formed when Markit acquired Quantitative Services Group in November 2011, developed the factors.

The new suite leverages the securities finance content set from Markit Securities Finance—formerly Data Explorers, which Markit acquired in April—that covers global inventory of more than three million intraday transactions, spanning $12 trillion of securities in the lending programmes of more than 20,000 institutional funds.

Markit Securities Finance provides global securities finance data, tracking short selling and institutional fund activity. Data is sourced directly from prime brokers, custodians, asset managers and hedge funds.

The new suite has found that the cost of shorting is among the top performing (the best in Europe) of all factors since January 2007, with a high and consistent return. It has beaten operating cash flow ratios, profitability ratios and interest cover.

The Implied Loan Rate factor, which is one of seven in the Short Sentiment Factors Suite, works for one month to six month holding periods, for most regions, and measures the cost (rate) of going short.

It has found that a high turnover strategy is not required to profit, with short selling insight proving generally right over a six month holding period across regions.

SS&C supports collateral management with new middle-office service

SS&C Technologies has launched GoTrade+, an advanced, flexible middle-office service for complex investment portfolios.

GoTrade+ supports post-trade activities of complex traded transactions including bilateral and cleared OTC derivatives, listed derivatives, loans and other securities.

The technology receives trade data from front office systems and delivers post trade life cycle support, valuations, collateral management, cash services, accounting, reporting and data delivery all wrapped in a personalised relationship management framework.

Carmine Ricciardi of Mizuho Securities US, a current SS&C client, said: "We leverage SS&C's GoTrade+ services to manage our OTC collateral processes. This provides us with a transparent, controlled and scalable infrastructure as well as subject matter expertise at a fraction of the cost of building and maintaining it ourselves."

"Many institutions who use complex trades such as OTC derivatives don't want to build the infrastructure to handle post-trade activities," said Jon Anderson, managing director of SS&C. "This is where we step in, we share our technology and expertise with our clients to provide comprehensive, independent web-based transparency on traded portfolios."

Good news for BNY Mellon in lawsuit

A 2009 lawsuit against BNY Mellon shows no sign of ending even though a judge recently denied a motion for class certification.

Three years ago, the Southern California IBEW-NECA Defined Contribution Plan alleged that BNY Mellon failed to invest the plan's collateral in a prudent manner when it held the collateral under its lending programme in Lehman Brothers.

BNY Mellon allegedly violated the Employee Retirement Income Security Act. The plaintiffs argued that it invested securities lending cash collateral in allegedly risky Lehman Brothers Holdings notes and then refused to sell the notes despite alleged warnings about the lack of liquidity in the credit market and declines in the market value of the investments.

After Lehman Brothers's bankruptcy filing, the plan lost "almost $3 million", said the plaintiff.

In response, the bank stated: "Monday morning quarterbacking cannot overcome the fact

Put it to work on your desk today!

- A robust tool for managing Inventory, Needs and Availability.
- Execute on Global Short-Sale Locates with full audit trail.
- Direct access for your customer eliminates phone calls.

Contact Amanda Sayers for more information

amanda.sayers@anetics.com ◆ 413.395.9500

Argent is a service mark of Anetics, LLC, Pittsfield, MA, USA

... and climbing.

A global player in asset servicing...

Offering leading value in investor services demands constant evolution. At CACEIS, our strategy of sustained growth is helping customers meet competitive challenges on a global scale. Find out how our highly adapted investor services can keep you a leap ahead.

CACEIS, your comprehensive asset servicing partner.

www.munier-bbn.com

Custody-Depositary / Trustee

Fund Administration

Issuer Services

www.caceis.com

caceis

INVESTOR SERVICES

solid & innovative

that the [Lehman] bankruptcy was a surprise to BNY Mellon as well as to the plaintiff, as shown by the fact that the plaintiff never asked BNY Mellon or any of the plaintiff's other investment managers to divest the plan's widely held investments in Lehman."

A judge in the US District Court for New York has now denied a motion for class certification filed by the board of trustees of the Southern California plan.

A team from Analysis Group, which includes managing principals Andrew Wong and Keith Ugone, and vice presidents Steven Saeger and Na Dawson, was retained on behalf of BNY Mellon to address issues related to class certification.

Ugone stated that a class-wide approach would mask important differences among proposed class members' individual investment expectations due to differences in the plans' maturity guidelines, credit-quality guidelines, prohibited investments, and diversification requirements.

Citing Ugone's report widely in his decision to deny the plaintiff's motion for class certification, Judge Richard Berman said that the plaintiff's claims failed to meet conditions of numerosity and commonality, because the plaintiff had not established that "common questions of law or fact predominate over individual issues."

Gottex Brokers opens US office

Gottex Brokers, an interdealer broker in interest rate derivative products, has opened its first office in the US.

The new Los Angeles office will focus on brokerage services in the secondary market for alternative investments through its specialised entity Gottex Brokers Alternative USA.

Acting as an intermediary between US institutional investors buying and selling secondary interests in hedge funds, private equity funds and real estate funds, the alternative division is a subsidiary of Gottex Brokers Alternative, which is domiciled in Switzerland.

Raphael Moreno, CEO of Gottex Brokers Group, said: "Volatility in the secondary markets for alternative investment shares has risen markedly in the past years and we have seen increased demand for investors to rebalance portfolios and to exit illiquid positions."

Bruno Bardavid will run Gottex Brokers Alternatives USA. Before joining the firm, he developed the credit trading markets for Mizuho International and West LB, London.

Gottex Brokers Alternatives USA will manage relationships with hedge funds, funds of funds, family offices, third party asset managers, public entities and sovereign wealth funds, private and investment banks, investment advisors and pension funds.

Misys finishes work on Summit FT upgrade

Misys has released Summit FT 5.6, an upgraded version of its Summit FT solution.

Summit FT 5.6 will help firms with swap definitions, methodology of pricing interest rate derivatives and central clearing.

"New features of Summit FT support the new swap definitions, OIS pricing, increased collateralisation of trades and connectivity to central clearers and reporting," said a statement from Misys.

DORMANT ASSETS IN GERMAN FUNDS?

www.comyno.com/securitiesfinance

Chart new opportunities with our Securities Lending solutions.

Who's helping you?

With increased pressure on margins, institutional investors need to consider every opportunity to enhance portfolio returns. At BNY Mellon, our experts will work with you to mobilize your idle assets through our suite of securities lending services. Working together, we'll do the small and large things that help you chart your path to success.

To learn more, please call:

+1 412 236 6065

bnymellon.com/assetservicing

BNY MELLON

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. Products and services may be provided by various subsidiaries, affiliates, joint ventures and in some instances by third party providers of The Bank of New York Mellon Corporation where authorized and regulated as required within each jurisdiction, and may include The Bank of New York Mellon, One Wall Street,New York, New York 10286, a banking corporation organized and existing pursuant to the laws of the State of New York. The material contained in this document is for general information and reference purposes only. It is not intended to provide legal, tax, accounting or other professional advice or investment advice on any matter, and it is not to be used as such. This document, and the statements contained herein, are not an offer or solicitation to buy or sell any products or services mentioned. This material is not intended for distribution to, or use by, any person or entity in any jurisdiction or country or in any circumstances in which such distribution or use would be contrary to local law or regulation or otherwise not authorized. Persons into whose possession this document comes are required to inform themselves about and to observe any restrictions that apply to the distribution of this document in their jurisdiction. ©2012 The Bank of New York Mellon Corporation. All rights reserved.

Collateral on demand

OTC derivative reforms are "made to shed light, and not heat", according to the Bank of England's Che Sidanius. SLT catches up with him to find out more about the central bank's paper on OTC derivatives reform

JENNA JONES REPORTS

What was the aim of the OTC Derivatives Reform and Collateral Demand Impact paper?

The aim of the paper is to estimate the initial margin (or collateral) resulting from the G20 commitments to clear 'standardised' OTC derivatives contracts through central counterparties (CCPs) and higher margin requirements on the remaining bilateral contracts. Our study covers only credit default swaps and interest rate swaps (ie, about two thirds of the interest rate derivative market by gross notional). It does not cover all derivatives. A secondary aim was to construct a framework where key variables can be calibrated in order to estimate what effect they may have on overall collateral levels.

While there are a number of studies that considered the effect of the central clearing mandate alone, we thought that it would be informative to model the potential collateral needed resulting for both OTC derivatives reforms. Another objective was to construct a framework where key variables can be calibrated in order to estimate what effect they may have on overall collateral levels. Some of these variables include assumptions on netting benefits that are associated with central clearing, proposed limits on the reuse of collateral or rehypothecation, and how market conditions affect the margin rates applied on the gross notional valued portfolios.

Given the opaqueness of this market and the uncertainty of how these reforms will affect market behaviour, we opted not to report a single number. Instead, we selected to include a range of results. It became very clear that the results are extremely sensitive to the assumptions that one makes, particularly regarding netting.

The methodology behind the paper limits the product scope to IRS and CRS because they are highly standardised and account for a significant share of the OTC derivatives market. Is it possible to see how OTC derivatives will affect collateral demand for the remaining non-standardised products?

The margin requirements for non-centrally cleared OTC derivatives are expected to be higher compared to more standardised contracts. This will translate into more collateral reflecting the generally higher risks with non-standard products.

Collateral could also be affected by any change in the regulation of the re-use of collateral in the bilateral market, commonly referred to as rehypothecation. Re-using collateral, whereby collateral pledged by a counterparty of a transaction is used in another transaction of a different counterparty, is a common practice among market participants.

How will the market have to change in order to embrace central clearing of standardised OTC derivatives once mandates come into effect?

I think that market participants will re-evaluate business strategies and operating models in order to accommodate the central clearing mandate. Legal and operational infrastructure needs to be sufficiently robust during the on-boarding process. Enhancements to risk management systems could help firms to optimise capital and liquidity management.

More emphasis might be placed on having the capability to source and manage collateral on a timely basis as CCPs can issue intraday margin calls on short notice. Clearing members may also opt to be connected to multiple CCPs and leave the choice of a CCP to its client.

How will market participants have to change their strategies to accommodate prospective margin requirements for transactions that are not centrally cleared?

As we point out in the paper, under Basel III, capital that is held against bilateral exposures is expected to increase capital requirements overall. An important driver is the credit valuation adjustment capital charge, which reflects the potential future change in the mark-to-market value of counterparty credit risk.

The initial margin rates on non-centrally cleared contracts have yet to be finalised but could require a minimum 10-day liquidation period, as opposed to the five-day period employed by some CCPs for OTC derivatives. Currently, collateral in the bilateral market is predominantly cash. Increased collateral needs might incentivise market participants to use more non-cash while improving collateral management capabilities overall.

What is demand for high quality collateral like at the moment and what does the paper say about how these reforms will affect it?

Since market participants regard only highly liquid assets—with a low probability of default—as high-quality collateral, assessments that the creditworthiness of some issuers has deteriorated narrows the range of assets that market participants accept as collateral. On the other hand, very large amounts of collateral that are accepted as high quality continue to be issued.

Collateral eligibility criteria differ according to regulatory jurisdictions but generally include cash, government securities and, in some jurisdictions, corporate bonds and equities. However, the International Monetary Fund points out that the number of sovereigns whose debt is considered safe could fall by some $9 trillion from the supply of safe assets by 2016.

Central clearing mandates and margin requirements for non-centrally cleared trades are not the only regulatory reforms that will affect collateral demand. For instance, banks will be required to hold an amount of highly liquid assets that are equal to or greater than stressed net cash outflow over a 30-day period. For the OTC reforms, the main driver of the collateral demand will stem from the requirement to post initial margin. While estimates of margin tend to be based on current trading patterns, it is likely that the patterns of trades or even amount of trades will change in response to margin requirements. In addition, it is still unclear how the market structure for central clearing will evolve, with new CCPs entering the regional markets and competing with incumbent CCPs. One consequence could be the fragmentation of central clearing, which would result in a reduction of multilateral netting. **SLT**

Che Sidanius
Advisor, financial stability directorate
Bank of England

Get on the Collateral Highway

Whatever your collateral destination

The right securities – at the right place – at the right time

© 2012 Euroclear SA/NV, 1 Boulevard du Roi Albert II, 1210 Brussels, Belgium, RPM Brussels number 0423 747 369

Emerging complex

Poland continues to beat but not buck economic trends in Europe, as SLT finds out

MARK DUGDALE REPORTS

A recent securities lending conference and market commentators have highlighted a decline in initial public offerings in 2012, lamenting the effect that an IPO decline has on lending supplies. While Central and Eastern European powerhouse Poland may not be bucking this trend, it is doing better than most.

According to a PricewaterhouseCoopers report, the Warsaw Stock Exchange (WSE) reported 26 IPOs on its exchange in Q3 2012. This represented more than 46 percent of all IPOs on European markets, and made the WSE the European leader.

The WSE also ranked fourth in Europe for IPO value, with its 26 IPOs worth €14 million. Only the London Stock Exchange group (17, €4.32 billion), the Luxembourg Stock Exchange (two, €54 million) and Deutsche Börse (five, €26 million) finished above it. But IPO figures for the WSE are down on previous years. It reported 61 IPOs with a value of €1.464 billion in Q3 2011.

With IPOs making Poland a leader in Europe, the country is looking to securities lending as it attempts to cement its position.

Terry O'Brien, EMEA head of equity trading, securities finance, at Citi, says: "Poland has promoted itself as the leading financial centre for Central and Eastern Europe. It has the largest stock exchange and one of the biggest derivative markets in the region. The WSE developed a new trading system which is about to be launched, and recently announced that it was looking to further develop its securities lending market."

As part of its strategy, the WSE identified key drivers for development in 2012. One of these drivers is a new trading platform that is scheduled for implementation in November. It will "improve the efficiency and expand the functionality of trading on markets in financial instruments operated by WSE", said the exchange.

Another driver is short selling and securities lending. The WSE is working with the KPDW (Polish National Depository for Securities) on a system that will support securities lending for short selling to "foster investor interest in short selling", said the WSE. They plan to launch it this year.

The KPDW's central counterparty clearinghouse, KPDW_CCP, is also developing an electronic securities lending platform that will centralise and transmit deal offers between lenders and borrowers.

In a statement, the KPDW_CCP said: "The project is particularly relevant to the development of short selling on the Polish market. Short selling requires the possibility of borrowing securities on the market for the investor to sell them at a certain time and later to buy them back at a much lower price and return them to the lender. Brokerage houses and banks whose clients want to use short selling to offer securities will be able to borrow securities on the market from other brokerage houses or banks quickly and effectively."

Andy Krangel, global product development head for securities finance at Citi, says that one of the key things about lending in Poland is the rules for a lender. "When you lend stock in Poland, unless you have a short sale agreement in with your local broker when you sell stock on the organised market, you must have the stock back from loan before you sell it, otherwise it is considered a short sale. You can technically sell on OTC. Short rules does not apply then but stamp duty may be applied."

"The short sale regulations in Poland are quite prescriptive. So as a lender, you can lend stock that is in your position, you can deliver it free to the borrower just like a standard market, but if you want to sell that stock, unless you have a short sale agreement with that local broker, you must have that stock back in your account before you sell it."

"That affects lending because there's no exclusion for a lending client that sells securities. They're not like some markets where a stock that's out on loan isn't considered a short sale; in Poland, unless you fulfill certain criteria, it is considered a short sale."

Citi added Poland to its lending network in February 2012. In a statement that was released at the time, the firm said that it worked closely with Polish legal and tax specialists so that it could create efficient and easy access to the country for foreign borrowers and lenders. "The addition of … Poland to Citi's lending network will open [the country] up to new sources of liquidity and support the development of [its] local capital markets."

Krangel adds: "We offer agency lending services to our clients that hold Polish securities. We can lend both fixed income and equities in Poland.

Citi decided to expand into Poland because it was "a market that we considered had the opportunity for our clients to utilise their portfolios further," explains Krangel.

But lending in Poland depends on "our clients' willingness to follow the rules of the market as with any other emerging market where the rules are more complex".

Krangel says: "We are very open with our clients on what they need to do, and we do have clients who are willing to lend in Poland. We tend to focus on selective names that are more event-driven: we wouldn't be looking to lend to general collateral names, because obviously the clients want to sell the stock, they have to get it back before they sell it, so we have to focus on individual opportunities."

"We're very proactive with clients on opportunities in emerging markets, the potential on individual loans and let the clients get very involved in the decision making process." **SLT**

CENTRAL COUNTERPARTY GUARANTEE.

UNSURPASSED RISK MANAGEMENT.

For nearly 40 years, OCC has provided high-quality clearing and settlement services and sound risk management at the lowest possible cost for the listed options market. Today, the protections of our financial guarantee and central counterparty role extend beyond listed options to financial and commodity futures, security futures, and securities lending.

THE FOUNDATION FOR SECURE MARKETS.

theocc.com

Not afraid to converge

Opinion on impending US regulations at the RMA's conference on securities lending was unanimous—in their current forms, they will cause problems. Experts regroup to consider the need for revisions and rule convergence

Neil Hiralall
Head of risk management
Brown Brothers Harriman Global Securities Lending

Michael McAuley
Global head of product strategy for securities lending
BNY Mellon

Gregory Lyons
Corporate partner and co-chair of financial institutions group
Debevoise & Plimpton

Nick Bonn
Executive vice president and head of securities finance and portfolio solutions
State Street

How are the various regulations converging in the US and what sort of business environment will there be when all is said and done?

Nick Bonn: In the US, the primary regulatory concerns for agent lenders are the proposed implementation of Section 165(e) of the Dodd-Frank Act with respect to credit concentration, and the proposed implementation of the Basel III capital agreement.

Section 165 requires the US banking regulators to impose heightened prudential standards—including capital, liquidity, risk management, and credit concentration—on "Systemically Important Financial Institutions," or SIFIs, which include all banks with more than $50 billion in assets, or non-banks that are designated by US regulators. Many agent lenders are, or could be, SIFIs, and will be subject to these new rules. For credit concentration, the regulators have proposed a new "Single Counterparty Credit Limit," or SCCL, which would limit credit exposure of single counterparties to SIFIs to either 25 percent or 10 percent, depending on the size of the bank, of a SIFI's capital.

For Basel III, US regulators have proposed implementing rules for both a standardised and advanced approach. Under Section 171 of Dodd-Frank (the so-called Collins Amendment), larger banks and holding companies will have to utilise both approaches.

While there are numerous aspects of both proposals that could negatively affect securities lending, a core element of both of these proposed rulemakings—credit concentration and capital—is the calculation of credit exposure to a banks' counterparties. Unfortunately, both the proposed SCCL and the proposed standardised capital rule adopt a similar deeply flawed methodology for calculating credit exposures resulting from agency securities lending.

Under the proposals, indemnified collateralised transactions are counted the same as principal exposures for the banks, so agency lending must calculate credit exposures under the rules for principal lending. Existing capital rules, and current industry practice related to credit concentration, allow use of simple VaR methodologies that incorporate market volatility of both securities lent and collateral taken, and do so in a manner that recognises netting and correlations.

In contrast, the regulators' proposals provide for fixed, non-risk sensitive haircuts on both the lending side and collateral side of each transaction. These haircuts do not take into account correlation effects across loan transactions or between loans and collateral.

As a result, the proposed credit exposure calculations do not reflect the actual risk that is embedded within a book of business between counterparties and the relative risks of different trading strategies are distorted. For instance, lending $200 of IBM that is collateralised with 102 percent cash has a much different risk profile than lending $100 of IBM that is collateralised with Apple stock, but these two transactions would incur the same credit exposure from a Dodd-Frank 165(e) perspective.

The SCCL proposal would limit the ability of agent securities lenders to indemnify for borrower defaults, and the capital proposal would dramatically increase risk-weighted assets for agent lenders, requiring increased holding of capital. The combination of both of these proposals would be a significant impact on the economics of beneficial owners and end users of securities, including market makers and firms looking to hedge exposures. Given the relatively low level of historical losses in the industry for both agent lenders and beneficial owners compared to the revenue that is earned from these transactions, the costs that are associated with this proposal will more than outweigh any benefits.

It should be remembered that these regulations are currently in the proposal stage. We have met with the relevant regulators and issued comment letters both as an institution, as well as part of larger groups such as the Risk Management Association (RMA), to voice our concerns about the potential unintended consequences of these proposals and offer alternative solutions.

Michael McAuley: Unfortunately, regulations are not converging. Each new proposal addresses its own legislative requirement without an assessment of the combined effect of all new regulation on the securities lending market or the financial markets in general. If all of these new proposals become effective in their current form, they could put US agent lenders at a competitive disadvantage to their international counterparts, significantly reduce the global securities lending market and negatively affect overall market liquidity. The good news is that most of these new rules are still in proposed form. So we still have some time to work with the regulators to fashion solutions that meet their objectives and are acceptable to our industry.

Gregory Lyons: As McAuley points out, while each proposal unto itself would be problematic, the real problem is the cumulative effect of these regulatory initiatives.

The industry recognises the strain of all of these rulemaking processes has imposed on the banking agencies. Therefore, members of the industry, as well as the RMA and other trade groups that represent them, have dedicated substantial time and expense to drafting comment letters that demonstrate the effect of each initiative, and also seek to show (hopefully) unintended consequences and conflicts of various proposals. For example, as to the Dodd-Frank 165(e) single counterparty credit limit rules, the RMA's comment letter highlighted that if the proposal becomes final in its current form, a 30 to 50 percent reduction in securities lending volume can reasonably be expected. The RMA's letters also highlight that because many of the Dodd-Frank rules would apply more severely to US institutions than foreign banks, so US banks could be put at a severe competitive disadvantage in the global securities lending industry.

Neil Hiralall: The vast majority of rules related to Dodd-Frank and Basel III have yet to be written or implemented, so it is difficult to say what the long-term impact will be to the securities lending industry. That being said, we can be certain that there will be higher capital and liquidity standards across the board imposed on almost all financial institutions with particular emphasis on those identified as SIFIs.

What is yet to be finalised is how much higher the capital and liquidity requirements will be for specific instruments and transaction types, and hence specifically which business lines or products will be most adversely affected when all is said and done. Most financial institutions today already have an internal capital allocation methodology, but the higher standards will force financial institutions to have a greater emphasis on return on economic capital, which may result in business lines competing for capital allocation. In turn, this may, at a minimum, affect the ability of certain business lines within affected institutions to grow, or may even result in shrinkage.

Dodd-Frank is proving to be a bone of contention—what is the situation with Rule 165(e) and how do you expect it to affect borrower default indemnification?

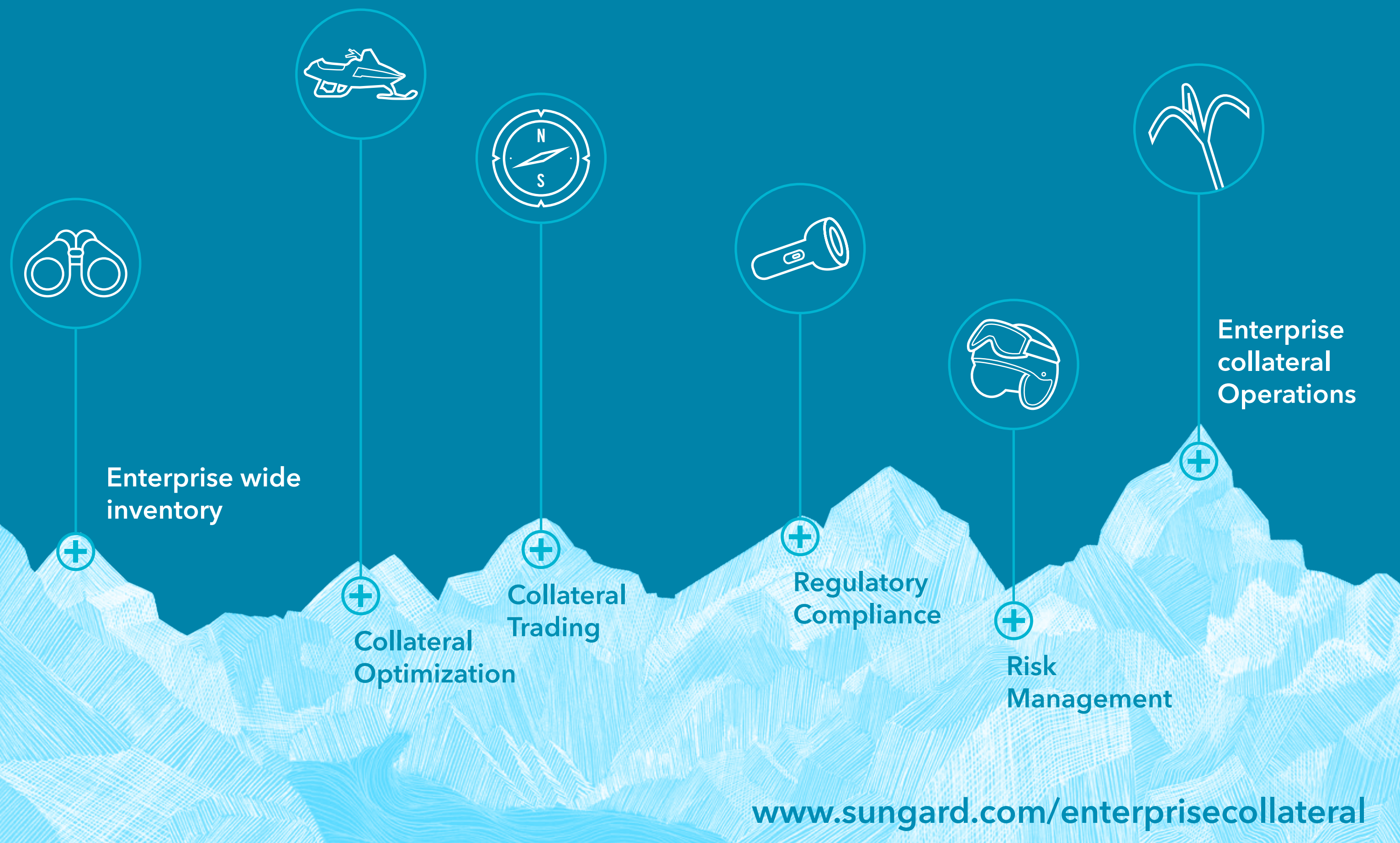
Hiralall: As probably already well known to most, Section 165(e) of Dodd-Frank, and the related rules that were proposed by the Federal Reserve Board, impose aggregate net credit exposure limits on certain institutions. This affects bank holding companies with consolidated assets of $50 billion or more, as well as non-bank financial firms designated as SIFIs (covered companies) by the Financial Stability Oversight Council. The proposed rules limit these institutions' exposure to any single counterparty to 25 percent of the covered company's capital stock and surplus. Significantly larger covered companies (more than $500 billion in assets) would have an even more stringent burden.

Exposures from securities lending contracts are expressly included. While the comment period for this proposed rule ended in April, it is still unclear when the rule will be finalised or what it will look like in its final form. That being said, as proposed, Section 165(e) could possibly cause covered agent lenders to reduce indemnified exposures to borrowers because of the cap that is applied across all applicable lines of business. Similar to the enhanced capital standards, it might force covered financial institutions to reflect on the terms under which indemnification is provided.

SUNGARD®

Apex Collateral.
The ultimate vantage point

You need to see the whole picture to achieve pro-active collateral management and optimization – not just parts of it.



www.sungard.com/enterprisecollateral

McAuley: Section 165(e) of Dodd-Frank imposes a strict numerical limit on the aggregate amount of net credit exposure that a consolidated banking organisation may have to any single counterparty. The Federal Reserve Board issued proposed regulations in December of 2011. Comments were due on 31 March. Nothing further has been issued. The initial effective date is 1 October 2013. The Federal Reserve Board has the authority to extend the effective date for up to two years. The borrower default indemnification provided to clients in agency securities lending programmes is treated for purposes of the proposed regulations as a direct credit exposure of the agent bank to the borrower of securities. Also, if collateral is used to offset exposure to the borrower, then an exposure is created to the collateral issuer.

The impact of the rule will depend on the methodology for calculating credit exposures. The proposed methodology uses haircuts that do not take into account correlations. The industry has requested in comment letters that the exposures be calculated using currently approved VaR models that more closely align the exposure with the risk. If enacted in their proposed form, the regulations would make borrower default indemnification a scarce resource that may need to be rationed by client or transaction types. Also, it could potentially limit the ability of the agent banks to accept certain high quality collateral for indemnified transactions.

Lyons: In my opinion, if Dodd-Frank 165(e) is finalised as proposed, it may provide the principal constraint on US agent bank indemnified programmes. As proposed, the mechanical approach that is promoted by 165(e) would have the perverse effect of forcing agent banks to move away from the highest quality borrowers and foreign collateral (because of concentration issues) when conducting their programmes. We have heard rumours that the Federal Reserve Board is delaying implementation of this rule to fully consider comments, and potentially even run an impact study on the proposal. I believe that the industry would encourage this in the hope that it would reduce the severe and inappropriate burdens that the proposals currently impose.

Bonn: Our primary concern with Dodd-Frank 165(e) relates to the proposed measurement of credit exposure from indemnified securities lending. We have other significant concerns as well, particularly the proposed requirement that if collateral is used to offset an exposure, as is standard practice in securities lending, the credit exposure is shifted to the issuer of the collateral. Since the US government is the only sovereign that is provided with an exemption from the limits under the proposal, the effect of the proposal will be to severely limit the amount of high grade collateral that can be accepted from non-US sovereigns, such as Germany.

These issues may make indemnified transactions with certain borrowers or taking certain collateral a limited resource. Where borrower default indemnification has previously been viewed as part of the overall lending package, it may become disparately priced in the future. As noted above, the US implementation of Basel III may also have a similar effect on the pricing of indemnification, as agent lenders will have a distinct cost associated with it. Therefore, indemnification will continue to be offered, but it may be viewed as a premium product feature and priced accordingly in the future.

What effect do you expect the Volcker Rule to have on collateral pools, and having said that, what will the final rules look like in December 2012?

Hiralall: The comment period for the proposed Volcker Rule closed in April with a statutory deadline for final rulemaking of July 2012, and the industry did put forward arguments as to why the rule should not apply to collateral pools. A final rule is still yet to be issued, however, so it is difficult to say with certainty. As currently drafted, the rules may limit an agent lender's ability to offer clients access to sponsored collateral pools. This would likely result in the use of more separately managed accounts as collateral reinvestment vehicles, or a shifting of cash collateral into registered money market funds.

Bonn: Collateral pools are not hedge funds or private equities funds, and should not, in our view, be affected as "covered funds" under the Volcker Rule. Unfortunately, as currently proposed, certain collateral pools could be captured as hedge funds under the proposed definition. It is unlikely that a Volcker "covered fund" could be used as a cash reinvestment vehicle for securities lending, due to the restrictions imposed on such funds by Dodd-Frank. State Street and the RMA have urged US regulators to modify their proposed rule to ensure that cash collateral pools are not inappropriately covered by the final Volcker Rule. However, if such a correction is not made in the finalised rules, it would require certain funds to be either wound down or reconstituted.

McAuley: The Volker Rule has very broad application. It potentially applies to accounts that pool the cash collateral of more than one legal entity. The rule potentially prevents agent banks from providing basic custodial services that are needed to administer commingled cash collateral accounts. It also potentially restricts the ability of agent banks to provide borrow default indemnification to funds that may be deemed affiliates or to other funds where the agent bank or an affiliate is an advisor or sub-advisor. It is possible that the rules may not be out by December of 2012. It would be very difficult—at this point—to predict what the rule might look like in its final form.

Lyons: As McAuley states, the proposal is very broad. Nonetheless, I am hopeful that the final rule will recognise that the proposal encompassing securities lending cash collateral pools was an unintended drafting consequence. A stated purpose of the Volcker Rule is to get banks "back to the basics". Securities lending, and the associated cash collateral pools, has been recognised by the agencies (through policy statements and otherwise) as a permissible bank activity for decades. The cash collateral pools do not allow speculative activities by banks, but rather merely provide an efficient means for the pooling of cash collateral, often on behalf of smaller clients. The RMA clearly described this in a comment letter, and in a meeting with the regulators. As a result, I would like to believe that in December 2012, or whenever the final rule is published (there are rumours of possible further delay), agent banks will have clarity that they will not be impeded from engaging in this traditional pooling activity.

How is the Financial Stability Board looking to address the "bilateral nature" of a 'shadow banking' practice such as securities lending?

Bonn: First, let me note that I do not believe that traditional agency securities lending should be viewed as 'shadow banking'. These are transactions undertaken by regulated banks and broker-dealers and therefore should be viewed in a different vein than shadow banking activities undertaken by non-bank entities.

With that said, it looks like the Financial Stability Board (FSB) will look to address the bilateral nature of securities lending transaction in a two pronged approach. One is to push for transactions to move to central counterparties (CCPs) and the second is to increase transparency. In terms of the CCP approach, unfortunately to date a model has not been commercially developed that will generate the benefits to agent lenders and beneficial owners that is required to mitigate the risks that are undertaken in these transactions. Further, there is some concern that CCPs may not be the panacea to reduce credit exposure and may create a greater concentration of risks.

As for transparency, we fully support efforts that increase transparency in a meaningful and cost efficient manner. Securities lending is already very transparent to our lending clients, with daily reporting of loan balances, borrower exposures, rebate rates, and collateral reinvestment details at the security level. We also support regulators gaining transparency to industry transactions, but would like this to be done in a coordinated, cost effective manner.

McAuley: The FSB's shadow banking taskforce established a workstream on securities lending and repo. The members of that group have completed their data gathering phase and are now working on developing proposals. It is expected that they will issue their proposals at the end of this year. Once that happens, we will have a much better idea of the potential impact on securities lending. Those proposals are likely to address transparency by suggesting some

form of global transaction data repository. They may also address margin levels, cash collateral reinvestment and rehypothication of collateral.

Lyons: To follow up on one of McAuley's points, Section 984(b) of Dodd-Frank also gives the US SEC the authority to "regulate" securities lending for the first time in the context of promoting transparency. The US SEC has yet to publish its required rules under that statute. It is possible that the US SEC is waiting for the FSB's shadow banking proposals before publishing its own, since both address at least some of the same issues.

What is of most concern to you outside of Europe?

Bonn: As noted above, the biggest and most concerning regulation outside of Europe is Dodd-Frank, which includes the single counterparty credit limit and the US implementation of Basel III. While we support prudent regulation of the industry, if the regulators fail to enact these in a thoughtful manner the unintended consequences could have a significant negative effect on not only agent lenders, but beneficial owners, including pension plans, and broader market participants due to reduced liquidity and higher trading costs throughout the capital markets.

We are also keenly observing how globally co-ordinated regulations will become. For instance, the FSB's final recommendations will likely be adopted globally by each G20 member state. We are already hearing rumours that proposals for a single counterparty credit limit on global basis may be coming. Ultimately, we hope that regulations in Europe, the US and globally will continue to maintain a level playing field, reduce the risk of regulatory arbitrage, and be considered in a deliberate fashion so as to ensure that a safer banking and capital markets environment can be achieved without creating a cost structure that may reduce the economic viability of undertaking activities that are critical to the health of our capital markets.

McAuley: Dodd-Frank 165(e) and the US implementation of Basel III, which includes the additional requirements of the Collins amendment, are the main concerns outside of Europe. The US proposals to implement Basel III and the Collins amendment utilise a haircut methodology that is similar to the 165(e) proposal for purposes of calculating the capital requirements that are associated with providing borrower default indemnification. These proposals would significantly increase the capital requirements for agent banks that provide indemnification. The good news is that the proposals for the time being exclude indemnified securities lending transactions from the new supplemental leverage ratio that is intended to capture off-balance sheet exposures. If that changes, it would be a significant issue for agent lenders.

Lyons: I think the biggest concern is not any one regulation, but the cumulative effect of all of the US regulations, and their integration with global regulatory initiatives. Many of these regulations could force seismic shifts in how US banks, in particular, operate, both as to securities finance and more generally. It is therefore critically important that regulators get the rules 'right', both as to substance and as to calibration, to prevent unnecessary damage or competitive inequality to the US banking industry (which is still expected to lead the recovery of the US economy).

The RMA, other trade groups, and myriad industry members have been seeking to assist with that, via comment letters, meetings with regulators, and other means. Regulatory staff are very bright and dedicated, and I just hope that they take the time and have the resources to carefully consider all of the comments, perform impact studies where appropriate, view the regulatory burdens on a composite as well as individual level, and end up with final rules that satisfy the statutory mandates, but also allow this critical industry to succeed. **SLT**

Services.
Scalability.
Solution.
Strength.
Support.

A complete solution for all your business needs and emerging requirements.

Stonewain provides a comprehensive, fully integrated solution for securities finance industry that is scalable, flexible and customizable to meet all your business needs.

info@stonewain.com 973.788.1886 www.stonewain.com

American reverse mergers

Andrew Shinn of SunGard Astec Analytics looks into the the strange but true practice of reverse mergers to assess whether they represent an opportunity for short sellers

A few years ago, Chinese reverse mergers were popular investments, as they allowed Western investors to access Chinese growth stocks. Many of those Chinese companies, however, were not good stewards of capital and shares in many Chinese reverse merger stocks are now worthless. While some Chinese reverse merger companies turned out to be frauds, the Chinese stock market as a whole has not proven to be an effective means for investors to participate in China's growing economy. Over the past decade, China's economy has grown 400 percent while the stock market has been flat. China's stock market regulators are currently trying to increase transparency and turn the local exchanges into true capital markets, but it remains to be seen how successful they will be.

But it's not just the Chinese that are playing catch-up. The US has had its own set of problems, not only with Chinese private companies conducting reverse mergers, but also with home-grown reverse mergers. A reverse merger is more amenable to fraud because private companies can become publicly traded without going through the more rigorous IPO process.

In May 2012, the US SEC expelled almost 400 shell companies before they could be used for a reverse merger. However, if a public shell company is not delinquent in its filings, it's difficult for the SEC to take action against it. A company could possess few assets, one employee and only a trickle of revenue, but still file on time and maintain its public listing. The company could persist in this zombie state for years, just waiting for a private company to merge with it in order to better access the public equity markets. In this context, Robert Khuzami, director of the US SEC's enforcement division, said in an announcement that "empty shell companies are to stock manipulators and pump-and-dump schemers what guns are to bank robbers—the tools by which they ply their illegal trade".

A quick online search uncovers dozens of firms willing to provide a "clean," "blank-check" shell company with "multiple market-makers" for any private company in need of financing. Typical fees are around $30,000, but some firms are willing to facilitate a reverse merger for much less. It's acceptable for a private company to pursue alternative means of financing, but too often reverse mergers are used by what Khumazi calls "pump-and-dump schemers".

On the other hand, reverse mergers offer investors an opportunity to sell these stocks short. Furthermore, US-based reverse mergers offer Western investors the ability to conduct due diligence more easily. With Chinese reverse mergers, investors could read reports, but conducting due diligence required taking a trip to China. One US-based company that is in the middle of a reverse merger right now is JMG Exploration. JMG was an oil and gas exploration company, and accumulated an equity deficit of almost $28 million over the last several years. It was pursuing opportunities in Wyoming and North Dakota, but all properties were sold as of January 2008, and at the end of last year the company didn't have enough working capital to fund continued operations. In 2011, the company lost $200,000 despite having annual sales of $96,000. It ended the year with $1.5 million in cash and just under $500,000 in liabilities. The strange thing is that despite zero sales growth in 2012, the company increased its market capital from roughly $4 million in Q1 2012 to $20 million as of 23 October 2012.

The transformation of a struggling exploration and production company with $1.5 million in cash into a $20 million company is due to JMG's new strategy of being a shell company willing to lend its reverse merger partner up to $1.5 million. In an 8-K that was filed on 29 August 2012, JMG announced that it will reverse merge with Ad-Vantage Networks, a development-stage digital advertising company, and JMG will lend Ad-Vantage $1.4 million.

Regarding Ad-Vantage and its business prospects, it's difficult to get information about the company. It doesn't help that JMG spells Ad-Vantage with a hyphen and AdVantage spells its own name without one on its website. While AdVantage states on its website that it was founded in 2012, according to JMG's 8-K, Ad-Vantage has "a history of losses [and] had a net loss for the year ended December 31, 2011, and for the year ended December 31, 2010. [Ad-Vantage] also had an accumulated deficit at December 31, 2011 and at June 30, 2012".

In an amended 8-K that was filed on 10 October 2012, Ad-Vantage disclosed that it had $2582 in revenue and a net loss of $670,979 in 2011. For the first six months of 2012, Ad-Vantage lost $999,912 on sales of $6365. Salary expense of $491,280 so far in 2012 is the biggest line item on Ad-Vantage's income statement. Ad-Vantage has funded itself over the last two years by issuing $2,151,999 worth of preferred stock. As of 30 June 2012, the company had an accumulated deficit of $1.9 million. Dun & Bradstreet and Hoover's don't have information for either Ad-Vantage Networks or AdVantage Networks.

Nevertheless, Penny Stock Shark states that AdVantage Networks "is a digital advertising technology company that offers internet access providers with proprietary networks, including hospitality, foodservice, and travel firms, a new stream of revenue by monetising the free or fee-based internet access they provide to their end customers. Ad-Vantage enables host networks to transform internet access provision from a cost centre to a profit centre overnight". Turning a cost centre into a profit centre is difficult, but doing so in less than 24 hours sounds too good to be true.

Equities are like call options with no expiration date. Therefore, investors that are buying shares of JMG and valuing the company at $20 million are buying call options on a business that has not demonstrated an ability to generate a profit. While the price-to-sales ratio for JMG's $96,000 annual revenue is 208, the price-to-sales ratio (which is already a dubious multiple) for Ad-Vantage's $13,000 in annual revenue (projected from first half results in 2012) is a shocking 1571.

From July 2010 to April 2012, AdVantage sold 6.2 million shares in private placements at an average price of $0.35. The most probable catalyst that will deflate JMG's current lofty valuation is when these private placement shares are converted into JMGE shares and subsequently sold for more than the $0.35 cost basis. According to SunGard Astec Analytics' Lending Pit, there are 40,000 JMGE shares borrowed and short sellers are currently paying 600 bps.

The best way to play these American reverse mergers would be to compile a portfolio of short sales to diversify the risk if any one of them were successful businesses. One way to go hunting for reverse mergers is to search the US SEC's EDGAR website filtering for 8-Ks and the words "reverse merger" since shell companies must file an 8-K announcing the reverse merger. Alternatively, broker-dealers have lists of companies formed as a result of a reverse merger. Those companies are often subject to 100 percent margin requirements since there's an elevated risk from investing in reverse merger companies. Bloomberg has a list of Chinese reverse mergers, but not an American reverse merger list. However, one may search recent M&A deals and filter by reverse mergers and the US. **SLT**

Adrew Shinn
Director of research, Astec Analytics
SunGard

Industry appointments

Bill Foley has become the director of portfolio solutions for the UK and Middle East within the market products and services team at RBC Investor Services.

The former director of securities lending sales will be based in London and will report to Simon Hirtenstein, head of portfolio solutions at RBC Investor Services, who joined the firm in June and previously worked at HSBC Securities Services and SIAM Consulting.

In his new role, Foley will work with client relationship directors and account teams to better understand new and existing clients' needs when it comes to market product services, including FX, cash management, securities lending and investment finance.

He will be responsible for defining and providing the appropriate products and services to support them. Catering for sovereign wealth funds will be a key part of Foley's responsibilities.

Foley joined RBC Dexia Investor Services in 2010 from J.P. Morgan in London, where he was senior sales executive for agency securities lending. Prior to this, he was global head of securities finance in Deutsche Bank's domestic custody division.

The California Public Employees Retirement System (CalPERS) has hired **Cheryl Eason** as its CFO.

In the newly created role, Eason will oversee the financial and risk management operations of the firm's $243 billion pension fund.

Prior to this appointment, Eason was vice president of the financial and plan board services for the British Columbia Pension Corporation.

Newedge has appointed **Michael Schulz** as chief risk officer for Newedge UK Financial.

Schulz will report to Mathieu Giovachini, group chief risk officer at Newedge, and Richard Wilson, CEO of Newedge UK Financial.

Giovachini said: "Newedge is continuing to grow a comprehensive and leading-edge internal control framework and Schulz joining further reinforces that fact. We welcome his valuable international expertise combined with a strong knowledge of capital market products and credit, market, liquidity and operational risk methodologies."

Schulz joins Newedge from Renaissance Capital in Moscow, where he was the group head of risk management.

Chairman and CEO of Pershing and a member of BNY Mellon's operating committee, **Frank LaSalla**, has been called to the board of directors of both Euroclear and Euroclear SA/NV.

The Euroclear board is responsible for the overall development of Euroclear's strategy, as well as the monitoring of its implementation.

LaSalla succeeds Timothy Keaney, vice chairman of BNY Mellon and CEO of BNY Mellon asset servicing. In addition LaSalla has also been appointed to the Euroclear board's remuneration committee.

"Euroclear plays an important role in facilitating financial transactions for our customers, and I know LaSalla will continue in our mission to make the process efficient and accurate for the industry," said Kearney.

LaSalla said: "This is a critical time for the European financial services industry, and I'm enthusiastic about the prospects of contributing to the smooth operation of the financial system through the work of Euroclear."

Vikram Pandit has abruptly left Citigroup after rumours that there were clashes between him and the board over strategy.

The new CEO will be **Michael Corbat**, previously the CEO of Citi in Europe, Middle East and Africa.

Pandit had been been at the firm for just five months when he was chosen in late 2007 to succeed Charles Prince, who resigned amid swelling losses from bad mortgage securities.

Pandit said of his departure: "Citigroup is well-positioned for continued profitability and growth, having refocused the franchise on the basics of banking. Given the progress we have made in the last few years, I have concluded that now is the right time for someone else to take the helm at Citigroup. I could not be leaving the company in better hands."

Michael O'Neill, chairman of the board, said that the board respected Pandit's decision, adding that he restructured and recapitalised the company, and demonstrated "leadership, integrity and resilience". **SLT**

SLT SECURITIESLENDINGTIMES

Editor: Mark Dugdale
editor@securitieslendingtimes.com
Tel: +44 (0)20 8289 2405

Journalist: Georgina Lavers
georginalavers@securitieslendingtimes.com
Tel: +44 (0)20 3006 2888

Editorial assistant: Jenna Jones
jennajones@securitieslendingtimes.com
Tel: +44 (0)20 8289 6871

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
Tel: +44 (0)20 8249 2615

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

Company reg: 0719464
Copyright © 2012 Black Knight Media Ltd.
All rights reserved.

Experts in Derivatives, Financing and Prime

Technology | Front Office | Operations | Advisory and Interim | Executive Search | Contingency Recruitment

equitylinked

We'd like to demonstrate how we can offer you a better experience so please talk to one of our team on +44 207 099 5430 or info@equitylinked.co.uk.

For more information, email Michele Westergaard here:

COLLATERAL MANAGEMENT

OPTIMIZATION OF COLLATERAL UNDER NEW LIQUIDITY CONSTRAINTS

New York, USA

5th, 6th and 7th November 2012

Collateral management is under increasingly sharp focus. Financial institutions working with collateral need to respond to the regulatory regimes that signal a fundamental change to the way trades are executed. The efficiency with which the buy-side and sell-side alike adapt to the changes will decide the profitability of collateral for the institution. This GFMI event will help financial institutions to understand what the new legislation means for collateral management and how to manage the liquidity squeeze whilst simultaneously achieving collateral optimization.

Attending This Premier Conference Will Enable You To:

- **Understand** the impact of Dodd Frank and Basel III on collateral management
- **Assess** the impact of CCPs and their potential risk
- **Structure** and manage an integrated collateral trading approach
- **Optimize** the use of collateral assets
- **Develop** an efficient margining regime under Dodd Frank
- **Overcome** re-hypothecation challenges with the increased liquidity squeeze
- **Analyze** the benefits of a move towards standardized CSAs
- **Align** collateral management practices with risk mitigation
- **Assess** the effects of the task-force on the tri-party space

"In the new environment, **collateral is king**"

Expert Speaker Panel:

Edward Corral
Global Head of Tri-Party Repo/Collateral Optimization
Morgan Stanley

Aamer Quadri
Global Head of Collateral Middle Office
Bank of America Merrill Lynch

Pete Campbell
First Vice President, Collateral Management, Fixed Income Operations
Ambac Financial Group

Clark Thompson
Director, Business Architecture
Credit Suisse

Andrew G. Auslander, CFA, FRM
Head of Risk Management
Itaú USA Asset Management

Atanas Goranov, CFA, FRM
Managing Director, Derivatives Risk Officer, Investments
The Guardian Life Insurance Company of America

Mark Faber
Head of Collateral and Counterparty Risk, Americas
Société Générale

Senior Repo Trader
BlackRock

John McPartland
Senior Policy Advisor, Financial Markets Group
Federal Reserve Bank of Chicago

David Maloy
Ex-Global Head of Collateral and Margin Management
Credit Suisse

Eric Lepore
Managing Director, Global Head of Cash and Collateral
Deutsche Bank

Marco Petta
Special Director, OTC Derivatives Market Initiatives
Bank of Canada

Dennis Shikar
Managing Director, Head of Equity Finance Trading, North America
Natixis Securities Americas LLC

James Wallin
Senior Vice President
AllianceBernstein

Mary Kay Scucci, PhD, CPA
Managing Director
SIFMA

Chad Burhance
Partner
NewOak Solutions LLC

Diana L. Preston
Deputy General Counsel
ABA Securities Association (ABASA)

John Ramsay
Deputy Director, Division of Trading and Markets
U.S. Securities and Exchange Commission (SEC)

Lana Bader-Kodsi
Senior Financial Officer, Collateral Management, Treasury Operations
The World Bank

Houman Shadab
Associate Professor of Law
New York Law School

Mark R. Szycher
Vice President, Enterprise Risk Management
GM Asset Management
awaiting final confirmation

Exhibition Sponsor:

Panel Sponsor:

Media Partner: