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Irish central bank: Aviva did not do its duty in securities lending

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The Central Bank of Ireland has fined insurance firm Aviva because it failed to properly check and control its securities lending programme.

Two fines of €1.225 million each were handed down to separate Aviva subsidiaries—Aviva Insurance Europe and Aviva Life & Pensions Ireland.

The fine is reportedly the fifth largest that the central bank has ever issued.

The central bank's insurance directorate discovered regulatory breaches in the Aviva subsidiaries' securities lending programme when it conducted a survey into insurance companies' use of liquidity swaps.

Aviva Insurance Europe and Aviva Life & Pensions Ireland entered into an investment management agreement with Aviva Investors Ireland—another subsidiary—in November 2000.

This agreement was amended in 2002, allowing Aviva Investors Ireland to outsource securities lending to a different subsidiary, Aviva Investors Global Services.

In June 2010, a novation occurred and the rights of Aviva Investors Ireland under the agreement transferred to Aviva Investors Global Services, and the subsidiary continued to perform securities lending on behalf of Aviva Insurance Europe and Aviva Life & Pensions Ireland.

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SLTINBRIEF

ESMA starts clock on UCITS guidelines compliance

National authorities of EU member states have two months to let ESMA know whether they will comply with its consolidated guidelines on exchange-traded funds and other UCITS issues.

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Hedge fund manager to pay $44 million for short selling

Sung Kook Hwang, a manager of two New York-based hedge funds, and his two firms have agreed to pay $44 million to settle US SEC charges over short selling.

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Irish central bank: Aviva did not do its duty in securities lending

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Between 2004 and 2012, the central bank found evidence that the firms failed to properly monitor and control securities lending that was carried out on their behalf, and that they did not review the adequacy of their overall investment policies.

It also found that the firms did not set risk limits in their securities lending programmes, or receive regular information on asset exposures and the risks that are associated with the practice.

In a joint statement, the central bank's director of credit institutions and insurance supervision, Fiona Muldoon, and director of enforcement, Peter Oakes, said: "Where a firm outsources investment activity, it must ensure that it has adequate investment policies, procedures and quantitative parameters to manage that investment activity in a way that is appropriate to the firm's balance sheet, and that it has sufficient information to allow it to properly monitor and control that activity."

"It is inadequate and unacceptable for firms to rely on group controls or group limits. The central bank reminds firms that they remain responsible for all regulatory obligations notwithstanding any reliance upon group controls or group limits."

In a statement, Aviva reportedly said that it accepted the central bank's findings and promptly rectified identified regulatory breaches, adding that none of the breaches affected its clients.

The Aviva subsidiaries shelved their securities lending programmes after the problems were identified. The central bank now considers the matter closed.

ESMA starts clock on UCITS guidelines compliance

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ESMA merged them with its guidelines on repo and reverse repo agreements on 18 December 2012. They will become effective from the end of the two-month notice period.

The authority released proposals for UCITS funds entering into repo and reverse repo agreements in July as a part of its controversial guidelines on ETFs and other UCITS issues that affect securities lending.

It published its repo and reverse repo guidelines in their final form on 4 December following a consultation period.

Under the repo and reverse repo guidelines, UCITS funds should be able to recall assets that are subject to repo arrangements at any time, while those that are engaged in reverse repo should be able to recall the full amount of cash at any time on either an accrued or mark-to-market basis.

ESMA originally proposed allowing a proportion of assets "to be non-recallable at any time at the initiative of the UCITS", and then only assets in overnight repo and reverse repo arrangements would be recallable at any time.

Its guidelines now apply to all fixed-term repo and reverse repo agreements that do not exceed seven days.

ESMA's guidelines on ETFs and other UCITS caused confusion when they were published, leading some commentators to believe that under the guidelines all revenue that is earned from securities lending would have to be returned to a UCITS fund and its investors.

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

Hedge fund manager to pay $44 million for short selling

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Hwang, who is the founder and portfolio manager of Tiger Asia Management and Tiger Asia Partners, carried out two trading schemes with Chinese bank stocks.

The US SEC alleged that Hwang and his firms committed insider trading when they sold short three Chinese bank stocks based on confidential information that they received in private placement offerings.

Hwang and his firms made $16.7 million in illicit profits, according to the US SEC.

Robert Khuzami, director of the US SEC's division of enforcement, said: "Hwang today learned the painful lesson that illegal offshore trading is not off-limits from US law enforcement, and tomorrow's would-be securities law violators would be well-advised to heed this warning."

Sanjay Wadhwa, associate director of the US SEC's New York regional office and deputy chief of the enforcement division's market abuse unit, added: "Hwang betrayed his duty of confidentiality by trading ahead of the private placements, and betrayed his fiduciary obligations when he defrauded his investors by collecting fees earned from his attempted manipulation scheme."

Raymond YH Park was also charged for his role in both schemes as the head trader of the two hedge funds that were involved, Tiger Asia Fund and Tiger Asia Overseas Fund. Park also agreed to settle the US SEC's charges.

Quadriserv to serve up repo platform

Quadriserv is working on a central counterparty (CCP)-based platform for equity repo, the firm has revealed.

It will build on its AQS securities lending facility, which is a CCP-based securities lending platform that offers automated stock loan trading in more than 5000 underlying equity, exchange-traded fund and American depository receipt products, to construct AQS Repo.

OCC will serve as the CPP clearer for the new platform, which has gained support from repo industry participants.

Quadriserv will continue to work closely with OCC and regulators in 2013 to create a venue that will meet the needs of securities financing repo participants.

BrokerTec and MTS release RepoFunds Rate

A fixed income trading platform and an electronic trading venue have teamed up to launch the RepoFunds Rate daily repo index for eurozone sovereign bonds.

ICAP's global fixed income trading platform, BrokerTec, and the London Stock Exchange's European fixed income electronic trading venue, MTS, are behind the index that reflects the effective cost of secured funding in key eurozone countries.

Repo businesses and dealers from major financial institutions were consulted on its development. The index will initially cover Germany, France and Italy.

RepoFunds Rate is based on centrally cleared, electronically executed one-business day repo transactions rather than indicative quotes.

These are based on a common settlement date and will include all Overnight, Tom-Next and Spot-Next trades in both general collateral and filtered specifics to accurately reflect the effective cost of repo funding for trades that are executed on BrokerTec and MTS.

All index data will be sourced from the BrokerTec and MTS electronic trading platforms, which together account for more than €250 billion of eurozone sovereign bond repos each day.

Data will be distributed broadly via third parties, including Reuters (REPOFUNDS) and Bloomberg (REPF), as well as through email and FTP sources.

The new indices will be published at the end of each business day. RepoFunds Rate data, including historical analysis, is publicly available online.

Bassma Elamir Riley, head of government bond repo at Deutsche Bank in London, said that RepoFunds Rate brings much needed transparency to the market and will provide traders with a more efficient repo hedging tool, "while simultaneously recognising the increasing role of collateral pricing in the OTC world."

Romain Dumas, managing director of EMEA short-term government products at Credit Suisse, added: "RepoFunds Rate should accurately reflect the cost of funding for the various types of collateral being used. As each trade will be centrally cleared, the counterparty dimension is removed to leave a purer measure of the secured interest rate, as essentially driven by the underlying collateral."

"At a time when uncertainty is a defining element of the eurozone sovereign bond world RepoFunds Rate delivers the high levels of transparency participants need to restore confidence in benchmarking and managing products referenced to the indices," said Oliver Clark, money market product manager at MTS.

"These indices are built on significant volumes of real trade data executed by a diverse range of pan-European counterparties on electronic platforms and cleared—not traded bilaterally—and therefore are solid, reliable and robust. The fast time to market for the indices, from inception to launch, is testament to what can be achieved when the industry works together."

EquiLend goes live with DataLend

Securities finance trading and post-trade services provider EquiLend has entered the data market with the launch of DataLend.

Its new product will allow it to compete with Markit Securities Finance and SunGard to provide transparency to the securities lending market.

Ten financial institutions, including BlackRock, Goldman Sachs and J.P. Morgan, back EquiLend. They are providing "high integrity data" to DataLend, according to a statement.

The new product uses proprietary quantitative cleansing methods to ensure the quality of its data, which is global and covers all asset classes, regions and securities.

Ben Glicher, chief information officer at EquiLend, said: "After an intensive and extended beta phase, it is evident that we are bringing top quality, thoroughly cleansed, unadulterated data to the securities finance market. We believe that our data is more than just competitive and it is our aim to become the industry leader in global securities finance market data."

Twenty percent growth for SEB prime brokerage platform

New SEB figures show a 20 percent increase in mandates on its prime brokerage platform over the last year. The platform has attracted 70 new hedge fund mandates in 2012, bringing the total number to more than 400.

SEB's fully segregated custody based model—which protects client assets without rehypothecation—has also proved popular with international clients. They have increased their business with SEB by 30 percent this year.

The re-launch of its FX Prime Brokerage service has also resulted in client trade flow, with SEB as prime broker, to grow by around 300 percent in 2012.

Peter Herrlin, head of prime brokerage at SEB, said: "Despite challenging market conditions, 2012 was a very successful year for SEB Prime Brokerage, and we are confident that 2013 will show an equality positive development. We are recognised as an intrinsic part of the strong Nordic macro environment."

Citi bags big Swedish hedge fund manager mandate

Citi will provide prime brokerage, custody and depository services to the recently launched Carve fund from Sweden's largest hedge fund manager, Brummer & Partners.

The mandate means that Citi, which has worked in Sweden since 1976, is now able to offer local prime brokerage, custody and depository services in the country.

"We are delighted to be chosen as prime broker for the Carve fund," said Mark Harrison, European head of prime finance at Citi. "In bringing together our Swedish depository and our global prime finance business, we have created a compelling and integrated offering allowing

the Swedish onshore hedge fund community to benefit from Citi's multi prime brokerage model."

Peter Thelin, CEO and portfolio manager at Carve Capital, added: "Citi's local presence, proprietary global sub-custody network and its ability to offer a multi prime brokerage model for Swedish investment funds, putting Sweden in line with the rest of Europe, have been important factors in our decision."

Citi can now support locally domiciled funds with independent depository capabilities, including oversight of funds' service providers, safekeeping of funds' assets, as well as daily automated monitoring of funds' investment guidelines and regulatory restrictions.

SIX acquires Oslo Clearing

SIX has agreed to purchase Oslo Clearing—which deals with central counterparty (CCP) clearing of financial directives and securities lending products—from Oslo Børs for approximately 180 million Norwegian krone ($32.4 million).

Oslo Clearing currently carries out CCP clearing of financial directives and securities lending products. Once the deal is completed, Oslo Clearing will be part of securities services, the post trade division of SIX.

Thomas Zeeb, CEO of SIX Securities Services, said: "[Our firm] has, since its inception, been at the forefront of interoperability initiatives in Europe to allow customers to benefit from greater competition and freedom of choice as to who they clear with."

"The acquisition of Oslo Clearing is complementary to our existing businesses and provides a further expansion of choice, both for existing SIX clients as well as Oslo Clearing clients."

Wells Fargo settles with Sarasota over securities lending feud

Wells Fargo will pay Sarasota County $23.75 million to settle claims that Wachovia Bank, which it acquired at the peak of the financial crisis, mismanaged the county's securities lending portfolio between 2007 and 2008.

Sarasota County's clerk of court and comptroller, Karen Rushing, filed a complaint against Wachovia in 2010.

Rushing engaged Wachovia in 2006 to enhance the performance of the county's working capital, but the financial crisis hit in 2008.

Sarasota County alleged that Wachovia negligently invested county funds in Lehman Brothers bonds and a collateralised debt obligation from Altius Funding.

Rushing argued that Wachovia failed to follow the county's extremely conservative investment guidelines when it invested in Lehman Brothers and Altius.

Wells Fargo assumed the liabilities of Wachovia when it acquired the bank at the end of 2008. It denied the allegations.

The case was scheduled for trial in federal court this month, but the parties have now agreed to settle. In a statement, Rushing said: "I think this is a very good settlement. The settlement resolves the litigation and brings in almost $24 million for the citizens of Sarasota County."

In a statement, a Wells Fargo spokesperson said that the terms of the settlement agreement will see both parties "making payments to cover losses incurred in the securities lending programme during a time of unprecedented market conditions".

"We strongly believe that the investments made by Wachovia on behalf of its clients in the securities lending programme were in accordance with investment guidelines and were prudent and suitable at the time of purchase. The firm was focused at all times on serving our clients' interests and we worked very hard and responsibly to achieve the best results for all of the participants in the securities lending programme, during very difficult economic conditions."

"In reaching this settlement with the County of Sarasota, we look forward to putting the matter behind us and focusing on helping our clients navigate the continued challenging market environment."

The bank continues to incur litigation costs since it took over Wachovia. In March, the City of St Petersburg persuaded a jury in Tampa, Florida, that Wachovia acted improperly when the city lost $10 million in Lehman Brothers bonds.

Wells Fargo is currently appealing against that decision, but in the same month—unrelated to Wachovia—a Michigan pension fund filed a suit against the bank alleging that it mis-sold the safeness of its securities lending programme.

Speaking at the time, a spokesperson denied the allegations and said that the bank would vigorously defend itself.

BNP Paribas handles second fund migration for Henderson

BNP Paribas Securities Services has migrated nine funds with an approximate value of €2.5 billion for Henderson Global Investors.

BNP Paribas will provide Henderson with custody, fund accounting, securities lending and foreign exchange services for the former Gartmore fund range. Further migrations are also planned for early 2013.

With these new arrangements, BNP Paribas will take custody of approximately €1 billion in Latin American assets, including a significant sum in Brazil.

This migration was not the first that BNP Paribas has handled on behalf of Henderson. In 2011, when Henderson acquired Gartmore, the bank played a role in integrating the middle office activities across all Henderson funds on to the existing joint platform.

Prior to this, BNP Paribas managed the integration of 114 funds totalling £7.6 billion in assets when Henderson acquired New Star Asset Management in April 2009.

BNP Paribas was also appointed to in-source the collateral management around Henderson's OTC derivatives activities.


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On the road

CCPs were the hot topic at the Global Repo and Securities Lending Forum

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The Marcus Evans Global Repo and Securities Lending Forum in London allowed speakers to open up about CCPs, triparty repo, collateral and the latest regulations.

ChinaTrust presented the Asian perspective on the securities lending market, NAB offered guidance on collateral transformation to meet obligations, and BarCap examined how European Central Bank policies such as the longer-term refinancing operation and zero rate deposit affected the market. There was clarification on how mandatory haircuts would be introduced and, as usual, some ideas about sourcing good quality collateral.

A UK FSA figurehead gave the latest news on the Financial Stability Board's (FSB's) proposals; a very timely sight for those who prefer their bad news to come in a friendly-faced package. Vital issues that have been flagged up by the FSB's recommendations include authorities needing to collect more granular data on securities lending and repo exposures, and a nudge towards trade repositories (TRs), which the FSB said "are likely to be the most effective way to collect comprehensive repo and securities lending market data".

However, this particular idea drew grumbling from one panel participant, who stated that the DTCC data repository costs large players in the derivatives markets "millions of pounds". **SLT**

CCP you later

A discussion centred on uncovering the impact of the CCPs in the repo and securities lending market—and whether regulators will force the securities lending industry to use CCPs.

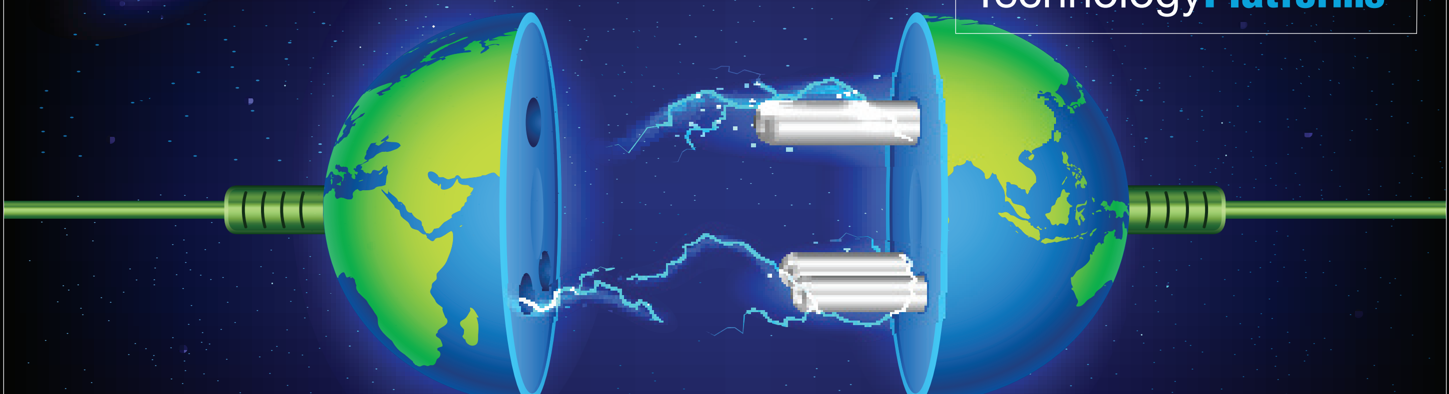
Participants, who included professionals from BlackRock, Daiwa and ING, looked at the logistics of pushing securities lending through CCPs and data warehouses, shared their experiences of repo in CCPs, considered legal implications and reviewed potential additional costs of central clearing.

It was agreed that CCPs would not suit every product, as the majority of business going through the CCP is relatively short-term, high volume.

A high barrier to entry—the US Dodd-Frank Act suggests that the minimum capital requirement to be a CCP member is $50 million—was hotly debated. "Regulators are going to be all over you," said one participant.

Margin requirements were deemed too arduous by one panellist: "It's developed quite a bit on the repo side (just over half), but not so much on the securities lending side. A lot has been done to explore the idea of a CCP in securities lending … and a lot of people are trying to bypass margin requirements. But we have to ask ourselves if CCPs are being too onerous in [their margin requirements]."

"The theory that persuaded people that this was a great idea was the idea of one global CCP by which everyone was connected. Of course, now we've got loads. The problem with one is there is no competitive pressure, but the problem with many is netting. It gets like airlines: every country thinks it will look good if they have one."



A borderless time

SLT talks to Jerry Friedhoff of Broadridge about breaking down barriers between desks, offices and locations as securities finance goes global

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What changes have you seen with the organisational alignment of securities financing desks across your clients?

Repo desks and now securities lending desks have aligned themselves more with the front office than the back office due to their revenue producing capabilities. These groups have similar trading economics and cultures but different regulatory and accounting treatments. A recent trend that we have noticed across our client base is that many firms are now also aligning their collateral management functions with the front office. They say this is happening because of the increasing revenue implications that are associated with their collateral management operations.

Does this mean that there are more synergies between these business lines than before?

Yes, because firms are looking for higher quality collateral to meet recent exchange obligations for central party clearing of OTC derivatives. These 'collateral upgrades' can be executed under a SLA (securities lending agreement), which influences the repo desk's trading activity. The volume of interactions between these groups has increased and we believe that it will continue to increase as new regulations unfold. There is a very real scramble for high-grade collateral that we are seeing across the industry right now. We are trying to anticipate our clients' cross-desk financing trading needs by providing an integrated position management solution across various asset and transaction types.

As global regulatory changes occur, what challenges do you foresee arising for your clients?

As global banks and broker-dealers try to meet global regulatory changes and intense funding expense reduction pressures, they are trying to evolve from a geographically segmented business model to a more global operating model. As they transition to this global model, they are often challenged in getting a holistic view of all asset classes across their regional offices. They are telling us that they need enhanced aggregation and trade execution capabilities to efficiently manage collateral requirements/opportunities across the various central counterparties.

Another challenge is the complexity of optimising collateral across the portfolio of options that they have. The complexity continues to increase as they layer regulatory changes onto their various funding models.

In addition, there are often difficulties in moving their inventories of collateral between various entities efficiently because of organisational and system silos that exist due to many years of business line independence. They want to be able to direct funding activities to the most advantageous markets around the world but there are sometimes system, organisational or process barriers that they need to overcome.

What about those that still regard various business lines as separate or part of the back office?

Part of our role as a solution provider to the securities financing market is listening to what our clients business objectives are and responding appropriately. There are a wide spectrum of organisational models that are used across the industry that we continue to support, but the more progressive firms are moving towards a revenue centric (ie, front office) business model for their global financing desks. We tailor our solutions to support the various securities financing stakeholders in the front, middle and back office regardless of how they are organised. Broadridge is less concerned with how our clients align internal user groups than how we can facilitate the end-to-end business requirements of the various stakeholders.

In a recent meeting with an executive responsible for global funding for a large Europe-based bank, he outlined a clear road map of current technological needs and his organisation's strategic growth plan. By looking at the roadmap, it is clear that the focus on collateral management is now becoming a front office priority, and the front office sees opportunities in the market to increase revenues by managing this process effectively.

What can a solution such as FinancePro do to satisfy these changing client requirements?

In March 2012, Broadridge announced the FinancePro Global offering to respond to the evolving market demands previously discussed. FinancePro Global is a multi-instance, multi-asset, back office agnostic securities finance trading system. Repo, securities lending and eventually collateral management desks will be able to use FinancePro as a common platform to manage their positions globally. FinancePro was designed to integrate well with Broadridge's securities processing solutions (impact for fixed income, BPS for equities and GLOSS for non-North American securities), as well as other third party processing platforms.

The aggregation capability of FinancePro will provide firms with a holistic view of collateral across multiple business lines. Our goal is to provide funding executives with the tools that they need to make timely, intelligent collateral usage decisions in this fast changing environment. **SLT**

Jerry Friedhoff
Product manager, securities financing solutions
Broadridge

Wins of change

SLT talks to Jane Milner of SunGard about the current prime brokerage landscape after an eventful couple of years

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How is the dynamic between hedge funds and prime brokers changing, and why?

The dynamic has been shifting as a direct result of events such as the failures of Bear Stearns and Lehman Brothers, and the repercussions are still being felt. These events, combined with the fall-out from the credit crisis, have been lining up to change what was previously a tight club of prime brokers offering a 'bundle' of highly personalised services, into what amounts to a broadening range of service providers offering specific elements of service.

This is being driven in part from the perspective of the hedge funds seeking to distribute their risk, but also from a viewpoint of the leading prime brokers, who, due to other balance sheet pressures, are less keen to do business with any/all hedge funds. Other institutions, such as custodians, which may now be holding the assets of the hedge funds, are also keen to enter into the fray in order to benefit from the new revenue stream that servicing hedge fund clients can bring through financing, short positions coverage and transaction charges.

How is the regulatory focus on prime brokers affecting their relationships with hedge funds?

Regulatory pressures are leading to more focus on how the capital of the firm is deployed across the business, in addition to greater focus on the counterparties with whom business is being done. The demand for asset segregation, and restrictions around the prime broker's access to hedge funds' assets to finance its own business, has clearly been a significant change. On the other hand, the regulation of hedge funds, under structures such as UCITS, has led to an increase in the growth of the number of funds, and the attraction of more institutional money into them. Overall, AUM by hedge funds is north of $2 trillion and is heading to an all-time high, and although there were a number of closures in the earlier part of the crisis, the growth in new hedge funds is now strong. These factors mean that hedge funds, and the provision of services to them, is a relative bright spot in comparison to many of the shrinking volumes and values that we see in other areas.

How important is it that hedge funds diversify their risks and increase transparency?

In common with other sectors in financial markets, the failure of leading prime brokers brought home to hedge funds the fact that risk was not all on the side of the prime broker, but that the larger financial institutions, such as investment banks, could also fail. This led to the spreading of risk across multiple prime brokers, and a demand for greater, and more frequent, visibility of the business being handled by the prime broker. In particular, the citing, and usage, of the hedge fund's own assets is receiving much attention. The requirement to have access to more detailed, and more frequent information, potentially in real time, has led to demands for improvements in the less interesting, but clearly critically important aspects of the daily interaction between hedge funds and their prime service providers.

What are prime brokers doing in response to this?

Prime brokers responded through the creation of bankruptcy-remote entities to house collateral, or in some cases partnerships were created between prime brokers and third-party party custodians in order to demonstrate the clear segregation of assets. The focus on client service providing visibility of the operational controls and reporting that are associated with the daily processing, and in particular asset utilisation as part of financing, became even stronger. There are certainly more conversations around the rather less exciting post-trade processing services than ever before, as hedge funds demand access to more in-depth and frequent information.

Where does the Apex Prime solution fit in?

Apex Prime was designed specifically to help the client services representatives manage the day-to-day operational activities and reporting demands in a more efficient way. It provides a one-stop-shop for all of the information that the service representatives need, ensuring that they can respond in an effective and timely way to hedge fund client demands.

Apex Prime is targeted to help new players that are keen to attract hedge funds flow and revenues, to get up and running with minimal cost and lead time. Historically, existing primes have employed huge IT resources in order to develop solutions to fulfill these requirements, and getting into the prime services business was only for those with very deep pockets for IT spend. Apex Prime aims to level the playing field by providing new players with an innovative solution to address the key, and specific, prime service functions. It can also help existing primes streamline processes and reduce costs in this area.

It also integrates closely with our securities finance solutions, but also with many other SunGard systems that are typically used by prime brokers, such as SunGard's trading, execution, back office, risk management, and regulatory compliance solutions. This has the advantage of reducing time and cost-spend on the implementation of the solution, which will clearly sit at the epicentre of a spider's web of other solutions at a prime service provider. **SLT**

Jane Milner
Head of strategy for securities finance collateral management and prime services
SunGard's capital markets business

Colouring inside the lines

Luxembourg is quietly continuing with securities lending activity, be it in or out of the country, as SLT finds out

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'Well-maintained' and 'prosperous' would be two descriptions that come to mind when thinking of Luxembourg, and the landlocked country has built on this reputation quietly over the years. Most banks are foreign-owned and have extensive foreign dealings, but Luxembourg has lost some of its advantages as a tax haven because of OECD and EU pressure. The economy depends on foreign and cross-border workers for about 60 percent of its labour force, and non-natives can enjoy an extraordinarily high standard of living.

But while foreigners may be flocking, lending activity for the large pool of assets that is domiciled in Luxembourg is not generally done in the country, with trading desks situated in London or Frankfurt. Citi noted that its Global Markets business has a securities lending and Delta One trading desk in Luxembourg, but added that the firm also deals with Luxembourg funds via its Global Markets London entity and Citi NA agency lending desks in Dublin and London.

ASLplus, a Clearstream offering that provides strategic lending to custody clients to earn additional revenue (with Clearstream acting as a principal lender), also operates from a trading desk in London. As for other firms, three entities that have advertised their securities lending operations in Luxembourg in the past declined to comment, citing a lack of activity in the region.

Gösta Feige, head of global securities financing sales and risk management in the EMEA at Clearstream, insists that lending activity is as competitive as ever.

"Given the sound legal framework and efficient CSSF regulation, Luxembourg is a perfect place for securities lending business and we definitely see immense growth in the actual securities lending business as well as the surrounding services. In our specific role as principal, the development of our strategic lending programme ASLplus speaks a clear language and has a solid growth track record which we foresee to continue, given regulatory pressure, industry need for sophisticated lending solutions and market need for reliable loan and collateral management services."

"Many of the major European banks have treasury desks in Luxembourg who transact securities lending and repo so the financing side of the market is already established although not significant compared to other European countries," says Jane Karczewski, EMEA head of equity finance sales at Citi in London.

"Most of the large asset management companies have their fund managers and heads of asset management based in their country of origin, so although more fund managers are being relocated to Luxembourg the decision making is generally managed by the local office. Until that trend changes, I do not think Luxembourg will grow substantially as a securities lending centre. Together with Dublin, it is one of the centres of European excellence for fund administration. That is a critical part of the securities lending, custody and UCITS markets."

Looking for the one-offs

Increasing demand from lenders for independent collateral management services means that the days of lenders giving mandates to a single custodian or agent for a host of services may be coming to an end.

Karczewski says: "In the context of OTC derivative collateral management, many institutions are indeed looking at the most efficient ways to centralise their collateral management. If they do not have the infrastructure to handle this operationally they are certainly looking at independent providers. Citi offers several collateral transformation options using Global Markets and Citi Transaction Services. We have securities lending clients using Citi or third part providers and similarly Citi provides collateral financing to clients who are not necessarily on the securities lending platform. I think it is safe say there is definitely more due diligence undertaken by beneficial owners with regard to collateral management, but the extent to which this is true still depends upon individual company profiles. 2013 will be a formative year in this respect."

Feige adds: "While we see indeed a growth of service providers in the collateral management area, we would rather say that there is a true need for reliable and holistic solutions, covering the whole value chain in a truly global liquidity hub, across boarders, settlement locations and service areas to combine repo, securities lending, collateral management services to ensure that clients can rely on exactly the services and tools and collateral whenever they need it. As those services, however, are rather complex to build and develop, we see true growth possibilities only for certain few very sophisticated players, based on their origin as market infrastructure and settlement depository."

As for diversification seen from beneficial owners—both in their investment and collateral portfolios—the consensus seems to be one of consistency.

"The investment profile from beneficial owners has not changed greatly over the last few years with ratios between fixed income and equity remaining quite stable," says Karczewski. "Certain asset managers have been moving into equities and focusing on the dividend paying names to compensate for the lack of fixed returns from bond portfolios. Pension funds specifically seem to be moving slightly more into equities to take advantage of the discounted market value and also appear to shifting a portion of their investment into index products. This could have a positive impact on the securities finance business but until both leverage and short interest increases we will not see any major benefits from this move."

"Collateral profiles are driven by the legal requirements determined by the jurisdiction of the beneficial owner. They are also determined by the operational efficiency of their lending provider and the beneficial owner's appetite for risk. We have seen larger beneficial owners opting for greater collateral flexibility in the forms of collateral accepted (cash, equities, government bonds) but, on the other hand, stricter parameters defining concentration limits and reinvestment products. Greater flexibility in forms of collateral accepted allows for a better distribution of assets."

Feige adds: "While we see—interestingly enough—increased securities lending business and lending mandates from beneficial owners due to our role as ISCD and neutral market infrastructure, where clients rely on our solid Luxemburgish legal grounds and our conservative measures and procedures, some clients indeed investigate details and background of our securities lending programmes, which we welcome."

"Effectively, customers join our programmes—again, where we act as agent, guarantor or principal, depending on the programme—thanks to our restrictive collateral schedules and to risk adverse lending services. Lenders feel comfortable facing Clearstream as principal in the strategic programme or having Clearstream as guarantor, on top of the pledge of collateral, in our fails lending programme."

(Don't) celebrate the quirks

Luxembourg's relevant regulation to lending, Circular 08-356, prescribes the conditions by which funds may enter into securities lending transactions. When it was overhauled in 2008, the regulator ended a 30-day limitation for securities lending transactions that put technical burdens on the back office.

One quirk of Luxembourg's regulation involves the level of collateralisation required to protect securities lending transactions. The minimum is set at 90 percent of the global valuation of the securities lent (interests, dividends and other eventual rights included) during the lifetime of the lending agreement.

CACEIS collateralises at 105 percent and other market observers note that they are unaware of any agents that take advantage of this regulation, particularly in an environment where lenders are carefully scrutinising counterparty risk.

"The regulation states a minimum requirement for Luxembourg regulated funds. However the standard of the securities lending market is 102 to 105 percent for bonds and equities respectively. The 90 percent minimum level allows for a buffer around market valuations and is not something Citi takes advantage of," says Karczewski.

Feige comments: "Given our nature as ISCD and market infrastructure, we are risk adverse and hence don't take advantage of this. Actually, we always take for our lenders a minimum of 102 percent of collateral. Our lending system manages collateral constantly and performs marking to market all over the day in order to make sure that our lenders are always collateralised."

This commitment to honesty is a characteristic that can only help the country's reputation. "Being based in Luxembourg helps in many ways," concludes Feige. "Not only due to the physical neighbourhood in the Grand Duchy itself as well as in central Europe to major sec lending players but also due to the favourable legislation, providing a solid and reliable framework on both the loan and collateral side." **SLT**

First past the post

Participants from Eurex Clearing, DekaBank and Comyno discuss the launch of the securities lending CCP service

At the end of 2012, Eurex Clearing's CCP service for securities lending went live and the first trades have gone through. How was it?

Thomas Wißbach: We are proud that we novated and processed the first bilateral securities lending transactions on our new lending central counterparty (CCP) service. Personally, it is great to see the fruits of more than two years work that began with consultations and workshops identifying the market needs up to the implementation and service readiness. I'm delighted to see that the lending CCP does work and that the pilot phase was successful.

Michael Cyrus: At DekaBank, we had a close look to see if Eurex Clearing's new service would keep with what was promised. Of course, we could have kept back saying that we'll jump on later when everyone else is already there, but in this case we wanted to support the idea right from the beginning. We see the efforts that went into connecting to the service and into being one of the very first pilot customers as an investment into our strategic product portfolio.

Markus Büttner: You won't be surprised to hear me say that we are indeed a bit proud to literally have seen the first trades from both perspectives making their way through the infrastructure—at the customers and at Eurex Clearing. With Comyno being the only firm to have worked on the CCP project at Eurex Clearing and at the same time taking care of DekaBank's internal business processes and technical changes, this really completes our understanding and competence in this area.

Do you think that many players will join now without regulatory compulsion given that so much budget and resources will be given to areas such as swaps (and derivatives) where CCPs are mandatory?

Büttner: Market participants seem to see the actual benefits of the CCP service more and more. After now having proof that the service works in real life, they begin to think what participation would mean for their organisations in particular. Other than only explaining how the CCP itself works, we are now asked about feasibility, business case creation and cost estimations for necessary project activities. I would be surprised if banks or beneficial owners are not jumping on the service with a positive business case!

Cyrus: Even without being forced into the lending CCP directly, there are still already existing regulatory and economic requirements that you can better address by making use of a CCP. These include—among others—much stricter balance sheet management as part of the structural deleveraging effects that we are seeing in the market, or as part of regulatory inventions, such the soon-to-be defined leverage ratios, but also the need for more transparency and stricter management of liquidity in all shapes or forms. Lending CCPs will also under certain circumstances be the way into better capital management, depending on the unfolding of the regulatory landscape. All in all, we see the lending CCP as a timely and strategic answer to several issues that will most likely become acute within the very next months and years.

Wißbach: There are many new customers in the pipeline to join the lending CCP in 2013. Aside from the regulatory aspects driving the market, all of the participants are looking to maximise their earning opportunities, as many of these participants see the ability to trade with a wider range of counterparties than they currently have access to. This is the case for both lenders as well as borrowers. In addition, there are a considerable number of operational tasks that the lending CCP undertakes on behalf of its clients, and this is another area where securities lending participants see the benefit of the CCP. We at Eurex Clearing have used this opportunity to automate many of the operational functions for the market, such as payments for dividends and monthly billing.

One of the big benefits is perceived to be that one could extend trading activities that would be hindered by bilateral credit lines if not using the CCP. Do you think this will be enough to offset the additional costs and margin requirements of the CCP?

Cyrus: Within the current market situation, that's a fair question. In a negative yield world, every basis point has the potential to change the economics of a trade significantly. But if the decision is to do the trade via a CCP or not being able to do the trade at all—because of a lack of credit lines—it is probably easy arithmetic. Now, in the real world, the truth will be somewhat in between these extremes. That said, Eurex Clearing needs to bear in mind that there is a direct connection between cost of the service and achievable flow. From my perspective, it is important to attract significant volumes in the initial phases of the roll-out. As we all know, flow begets flow, and so pricing at inception of the CCP will have a direct impact on its success.

Wißbach: Of course, there are costs of using the lending CCP, but we believe that the economic benefits are far greater for users of the service. There are a number of factors that potential users have to weigh up before deciding for or against the service. It's not just a case of looking at the CCP fees or margin cost in isolation. We are able to run through a number of different trading scenarios looking at a number of different trading relationships that can be established using the lending CCP. We take into consideration the use of collateral and the financing costs and then factor in the zero weighting of the CCP for the capital requirement calculation for each customer—the result is a substantial gain for the planned participants and their potential transactions.

We believe that our pricing is competitive for the service that we provide and for the benefits we bring to the securities lending market. On top of that, we are currently waiving all CCP fees, ie, our members get the benefit of transacting with zero cost for clearing. There is even a more direct benefit that is available to agent lenders in the fact that they would no longer have to have the cost for indemnifying their clients as the lending CCP effectively provides the same counterparty default protection that the indemnification is intended for.

Büttner: From an integrator's point of view, users of the service need to make sure that the integration of CCP driven in-house-processes are designed straight through. This should be achieved within the flow of trade information, fees, margin and also tri-party collateral information. To keep the cost as low as possible for both setup and running the service, it's very important to not only integrate it properly into the front office, but also other departments in the process chain are similarly crucial to make this an efficient exercise. The effects of a lending CCP trade need to be handled correctly in credit risk, market risk and finance to be able to get all of the benefits out of it. That's why experienced people should see the introduction of the service through at the customers end as well. If all those boxes are ticked, the benefits will certainly outweigh the effort.

As 2013 begins, where do you see the service in 12 months?

Cyrus: This will depend on some of the issues outlined above. However, we would certainly see and hope for many more players and much higher volumes. We expect that other lenders and borrowers will look closer into this business opportunity and understand the benefits in connecting to the service. Being an early adopter, we are looking forward to expanding jointly, and in cooperation with other players, our business on the CCP.

Wißbach: Many other customers are planning their integration to the service in the first half of 2013 when the service will be extended to include fixed-income securities in Q1 and further European equity markets in Q2 (France, The Netherlands and Belgium). Further functional and geographical enhancements are in the pipeline for the second half of 2013 and 2014, such as the inclusion of UK-listed securities. All enhancements to the service will be designed and planned in conjunction with our customers' requirements and requests for any new functionality and market coverage.

Büttner: Being in the unique position of having supported both ends of the service, we are excited to see the service expanding and new customers integrating to the service, and we are expanding into London to deal with the expected opportunities. Of course, we look forward to further supporting Eurex Clearing in the service extension that is planned for the next months, but we are also keen to support other customers with their integration plans to the service. **SLT**

Markus Büttner
CEO
Comyno

Thomas Wißbach
Senior vice president
Eurex Clearing

Michael Cyrus
Head of short term products
DekaBank

Three hearts beating as one

David Field of Rule Financial examines the triparty model to check the pulse of the collateral system

The post-crisis reform of the financial markets has focused to a large degree on the management of counterparty credit risk. The cleared market model, in which a central counterparty (CCP) is inserted between the principal parties to a trade with the specific purpose of concentrating and mitigating counterparty credit risk exposures, has been imposed on markets where the prevailing bilateral model was deemed to be insufficiently transparent and robust. The transition of the OTC derivatives market to central clearing is now well advanced, with key legislative and regulatory measures such as the US Dodd-Frank Act and the European Markets Infrastructure Regulation (EMIR) entering into force throughout 2013. Other principally bilateral markets, such as that for repo and securities lending, may follow suit, driven either by market-led innovation and evolution, or by regulatory diktat.

A common feature of the new market structures is the formalisation of collateral practices. In the bilateral world, counterparties were generally free to agree the basis on which exposures should be secured by the pledging or delivery of collateral assets. Best practice and standardised documentation, such as ISDA Master Agreements and Credit Support Annexes (CSAs), Global Master Repo Agreements (GMRAs) and Global Master Securities Lending Agreements (GMSLAs) evolved, with market participants retaining the ability to tailor collateral arrangements. This had the advantage of enabling firms to take into account the nature of their counterparty when agreeing terms of business; an insurance firm or institutional investment fund would face significantly less onerous margin requirements than a leveraged hedge fund, for example, allowing for the most efficient deployment of assets relative to risk. Unfortunately, the lack of strict rules arguably resulted in systematic under-collateralisation of exposures and aggressive re-use of collateral assets, with the result that when counterparty credit risk exposures turned into real credit losses in the crisis of 2007 to 2008, many institutions found themselves unprotected.

The formalised quantification of counterparty credit risk, the exchange of collateral and the maintenance of adequate capital reserves are therefore central to the new regulations. Collateral assets may be regarded as the lifeblood of the financial system, circulating to secure exposures in the various 'organs' such as CCPs and secured lending markets.

The health of this circulatory system depends critically on the heart driving blood through healthy arteries and veins. The step change in the value of collateral that is required to sustain financial activity has created the need to move assets with the minimum of friction and cost to where they can be most efficiently deployed to secure exposures and support investment and hedging strategies. A lack of available collateral assets relative to the desired level of activity, whether because of competing demands or narrow eligibility criteria, will lead to anaemic and inefficient markets in which risk managers are unable to hedge effectively and speculators cannot provide liquidity. If the arteries of the financial system are clogged by excessive transaction costs or cross-border settlement obstacles, the financial markets are again likely to prove unfit for purpose.

We believe that the triparty model is developing into the heart of the global financial collateral system. Evolving from the repo markets, triparty collateral agents offer market participants an efficient means of allocating collateral. The foundations of a viable triparty provider are: (i) a large network across which securities can readily be moved between the accounts of many collateral givers and collateral takers on a book-transfer basis; and (ii) robust legal arrangements that determine the treatment of collateral under normal conditions and, critically, through the counterparty default process. On these foundations have evolved value-added services such as collateral optimisation, by which the most efficient allocation of securities that are available to a collateral giver is systematically computed and implemented, given the prevailing exposures and constraints such as collateral takers' eligibility and concentration criteria.

Four institutions currently offer global triparty collateral capabilities; the two international central security depositories (ICSDs), Clearstream and Euroclear, and two large global custodian banks, J.P. Morgan and Bank of New York Mellon. Barriers to entry are substantial, particularly in terms of the breadth of network and level of initial investment that is required, but we expect that other global custodians will seek to offer triparty services in partnership with one of the established agents.

Triparty agents are also well-placed to address a new requirement that is becoming apparent as central counterparties, clearing agents and non-clearing institutions grapple with the new rules for the collateralisation of OTC derivatives. Under normal circumstances, collateral to meet initial margin requirements is called by the CCP. The clearing agent must meet this obligation, and to do so will in turn call for collateral from its non-clearing client. Unlike the established futures model, in which non-clearing institutions' collateral could be commingled by the clearing agent and only the net collateral requirement passed on to the CCP, the new rules demand that CCPs and clearing agents segregate collateral assets to reduce the risk to the non-clearing institution that its collateral may be consumed in the event of the bankruptcy of the clearing agent or one of the clearing agent's other non-clearing clients.

Collateral segregation, whether in the Legally Segregated Operationally Commingled (LSOC) model prescribed by US regulators or the omnibus and individual segregation options set out in EMIR, creates substantial operational overhead across the clearing chain. However, the evidence suggests that non-clearing institutions will take advantage of the new protection that they are offered, even though the trade-off in both cost and operational complexity are not yet fully transparent.

The segregation of collateral assets is, however, only part of the story. Market participants are exploring alternative means of meeting their collateral obligations while minimising counterparty credit risk and transit risk. A non-clearing institution may not wish, or be allowed, to park securities at its clearing agents, but would prefer to allocate collateral directly to the clearing house. Alternatively, where bilateral exposures remain, the new regulatory framework requires that collateral is delivered to a third-party custodian to minimise potential disruption in the event that one or other counterparty to the trade falls into default.

In conjunction with collateralisation rules that are set out in Dodd-Frank and EMIR, the Basel III capital adequacy standards reinforce the prevailing capital requirements that are associated with counterparty credit risk. The revised treatment of trade exposures and posted collateral will make a material difference to the cost of OTC derivatives activity, and must therefore be evaluated carefully in the analysis of the optimal collateral segregation model.

Clearing members of a qualifying CCP must apply a flat 2 percent risk weight to trade exposures for the purposes of calculating their counterparty credit risk capital charges. CCP default fund contributions must also be reflected in capital. A bank accessing a qualifying CCP as a client of a clearing member faces the same 2 percent risk weight if particular account segregation and portability requirements are met. An intermediate risk weight of 4 percent is applied if the non-clearing bank is exposed to loss in the event of the joint default or insolvency of both its clearing agent and another of the clearing member's clients, but is otherwise protected. Alternatively, if the non-clearing institution is exposed to loss if either its clearing agent or one of its clearing agent's clients default or become insolvent, the non-clearing institution's exposure must be treated as a bilateral trade, leading to a substantially higher capital charge. If the non-clearing institution is not a bank, then of course it does not face capital requirements directly, but will certainly see the cost of the additional capital that must be held by its clearing agent in derivatives pricing or other service charges.

In general, equivalent counterparty credit risk capital charges also apply to collateral that is posted by a non-clearing institution to a clearing agent, or by a clearing agent to a CCP. Significantly, collateral that is posted to a clearing agent or a CCP is not subject to a counterparty credit risk capital charge if it is held in such a way that it remains bankruptcy-remote from the clearing agent or a CCP, for example, at a custodian.

This creates an attractive opportunity for providers of custodial services to offer collateral management services that minimise the incremental capital and operational costs to participants in the cleared and bilateral OTC derivatives markets. One new configuration that is emerging to support requirements of participants in the cleared derivatives market is the 'quadparty' model, which builds on the functionality and flexibility of triparty collateral management and links together the CCP, the clearing agent and the non-clearing client institution as shown in the box out.

The quadparty model offers clear benefits to the collateral giver, as it can now allocate securities directly to the ultimate collateral taker (the CCP), achieving the desired bankruptcy remoteness from both CCP and clearing agent. The CCP is largely unaffected; it continues to receive eligible collateral in response to its margin calls to the clearing agent through the triparty structure.

The key to a functional quadparty model is the co-operation of the clearing agent. The challenge for the clearing agent is that it has effectively been dis-intermediated from the collateral chain, and no longer receives securities from its non-clearing client either directly or through the triparty system of accounts. However, as the principal to the cleared trade with the CCP, the clearing agent is directly exposed should its non-clearing client fail to deliver adequate collateral to the CCP through the quadparty structure. In order to support a quadparty structure then, it is likely that clearing agents will require some form of security interest in the non-clearing institutions collateral assets.

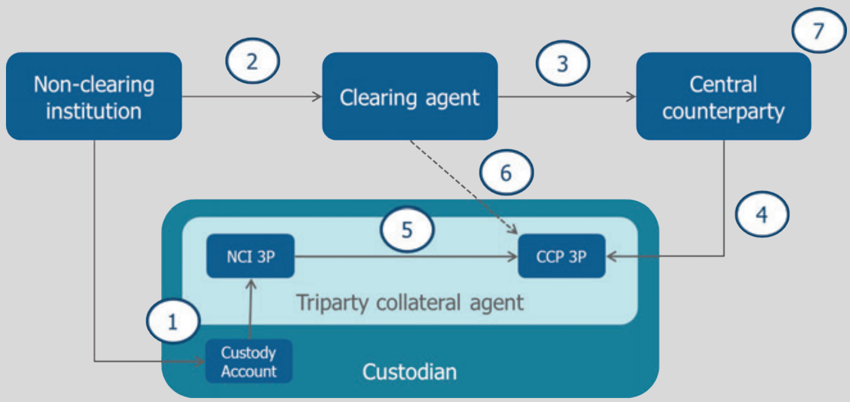
Clearly, quadparty legal documentation will be complex in order to meet the competing demands of the participants. No legal standard exists as yet, but we are aware of some firms that are close to maturing legal opinion. The operational challenges also appear formidable, particularly in terms of the propagation of account segregation all the way from the CCP through the clearing and triparty agents' respective books and records. Initially, we expect only large non-clearing institutions with sufficient leverage as clients of the key clearing agents to be able to move the quadparty model forward. However, once a functioning model is established, more widespread adoption is likely if the benefits can be captured at reasonable cost.

Market participants of all types are facing a fundamental concurrent overhaul of major components of the financial system. Inevitably, unintended consequences of the regulatory reform programme will need to be flushed out and addressed. The step-change in demand for eligible securities will drive innovation in efficient sourcing and deployment of these assets, and we expect the continuing evolution of the triparty model (including quad-party arrangements), in order to cater for many of these requirements.

In recent emergencies, central banks have applied the 'liquidity defibrillator' to maintain a stable flow of assets, preventing cardiac arrest by overcoming self-fulfilling symptoms of illiquid or insolvent counterparties. Where key institutions have fallen (or risk falling) into bankruptcy, thereby threatening the viability of the financial system, central banks have applied extreme measures to maintain the overall health of the system. The key question remains, can the collateral circulatory system be sustained in healthy condition through sustainable innovation and market discipline, or should we expect to see more overt and intrusive regulatory activism to deter or preclude risky activities that may otherwise result in future critical financial health problems? **SLT**

David Field
Specialist in clearing and collateral management
Rule Financial

The evolving 'quadparty' collateral configuration model



1. Non-clearing institution instructs custodian to move securities into its triparty collateral longbox from its custody accounts;
2. Non-clearing institution instructs clearing agent to lodge triparty collateral at the CCP in anticipation of submitting a new derivatives trade for clearing;
3. Clearing agent requests CCP to accept a lodgement of triparty collateral value on behalf of the non-clearing institution;
4. CCP issues RQV (Required Value) instruction to the triparty agent to receive securities into the appropriate CCP's collateral receiver account to the value specified in the lodgement request;
5. Triparty agent allocates securities from the non-clearing institution's longbox account to the CCP's collateral receiver account;
6. Under the likely form of a quadparty collateral agreement, the clearing agent establishes a security interest in the collateral securities that are allocated to the CCP, ensuring that it can take over the collateral in the event that the non-clearing institution falls into bankruptcy;
7. Triparty collateral value is recorded in the books and records of the CCP, and is available to allocate against any liability that is incurred by the non-clearing institution.

This process meets several goals:

- The non-clearing institution has delivered collateral to the CCP without incurring the cost of any market movements or transit risk, the triparty agent has selected optimal securities for allocation and its collateral is bankruptcy-remote from both the clearing agent and the CCP;
- The clearing agent can be confident that the non-clearing institution has pre-funded its collateral account at the CCP, minimising the risk that a new trade submitted for clearing will not be accepted and that it will be required by the clearing house to meet any incremental initial margin liability;
- The CCP has access to eligible securities in the event that either the non-clearing institution or the clearing agent defaults, and avoids the operational overhead of processing non-cash collateral on a bilateral basis.

We do not expect triparty collateral value to be acceptable to CCPs as a means of meeting variation margin obligations in the near term, although this could represent a viable approach to accepting securities for this purpose, addressing one of the major challenges of OTC derivatives clearing for many buy-side market participants. For the time being, CCPs will continue to demand cash in respect of variation margin calls in order to avoid liquidity mismatches between cash inflows and outflows.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Repositioning repo

SLT's experts discuss ESMA's new guidelines, Basel III, overhaul of the triparty model and the possibility of Asia moving away from bilateral trading

Stefan Lepp
Member of the executive board and head of global securities financing
Clearstream

Saheed Awan
Global head of collateral management and securities financing
Euroclear

John Rivet
Global collateral management business executive
J.P. Morgan

Iain Colquhoun
Head of repo sales
Mitsubishi UFJ Securities Int Ltd

James Tomkinson
Specialist in OTC clearing and collateral management
Rule Financial

Mark Dugdale
Editor
Securities Lending Times

ESMA's guidelines on repo and reverse repo agreements for UCITS funds are out and being prepared for implementation—are these what you expected and why?

John Rivet: The big concerns relate to where the collateral can be held, combining limits with derivatives and restrictions on rehypothecation. The application of a general 20 percent issuer limit restriction, which also includes government debt, may have an impact on liquidity and financing in the market. There are more and more demands for high quality collateral, so to place a restriction on good quality sovereign debt and government bonds is surprising. There was an expectation that high quality government debt would be exempt, in particular for markets that have specific collateral eligibility requirements. For example, in the US repo market, US treasuries would be the predominant form of acceptable collateral.

In general, some proposals still lack detail and the market must await additional information.

Saheed Awan: For repo and reverse repos, UCITS should only apply to such agreements if the assets or the full amount of cash are recallable. The European Securities and Markets Authority (ESMA) considers fixed-term repo and reverse repo agreements that do not exceed seven days as arrangements that allow the assets to be recalled at any time. Notwithstanding the ability of money market funds to be able to redeem investments within short time frames, we find it surprising that ESMA is so restrictive so as to prevent such funds from engaging in more desirable longer-term repo transactions. Nor do we see how ESMA's guidelines will help the markets to secure more stable, longer-term funding.

It is also surprising that ESMA puts no restrictions on funds placing their cash balances in unsecured deposits, while they do place restrictions on what the funds can do with their cash in the far safer repo market.

In contrast to ESMA, another set of regulations in the form of Basel III does encourage longer and highly stable sources of funding. Is this a case of one regulator pushing one way and another going a different way?

James Tomkinson: The following is a summary of the key guidelines:

- For repo arrangements, UCITS funds should be able to recall at any time the assets subject to such arrangements;
- For reverse repo agreements, UCITS funds should be able to recall at any time the full amount of cash on either an accrued or a mark-to-market basis. However, when cash is recalled on a mark-to-market basis, the mark-to-market value of the reverse repo agreements should be used for the calculation of the NAV of the UCITS funds; and
- ESMA considers fixed-term repo and reverse repo agreements that do not exceed seven days, as arrangements that allow the assets to be recalled at any time by the UCITS funds.

The repo/reverse repo guidelines for UCITS funds are not only generally in line with expectations, but they are also aligned with current market trends and practices. Repo and reverse repo products represent a relatively safe-haven money market alternative for cash investments (reverse repos), and evidence suggests that the secure nature of reverse repo has been increasingly employed over recent times by funds as a short-term money market investment mechanism.

Market trends reported in the European Repo Council's (ERC) Repo Survey for June 2012 indicate a significant increase in the use of open repo transactions. The most recent survey reported that 58.6 percent of all triparty transactions were traded as open transactions, with a further 20 percent of triparty repo trades transacted with maturities of one week or less. This indicates that approximately 80 percent of all current triparty repos would already comply with the proposed ESMA guidelines.

The increase in short-term triparty activity is indicative of increased UCITS fund participation in the triparty repo market, and particularly in reverse repos. Although evidence is anecdotal, there is no doubt that there is an increased participation in the triparty repo market reported by service providers (that was not recorded in the ERC survey), this in turn indicates an increased participation amongst non-bank financial institutions (ie, UCITS fund or UCITS-like institutions).

How will the guidelines affect UCITS funds?

Rivet: ESMA published its final set of guidelines in late December 2012. It will enter into force in February 2013, allowing for a phased implementation for UCITS funds that were created before the date on which the new guidelines apply. As a result of this phased implementation, many market participants have not completed their analysis of how their funds structures will be affected. UCITS funds will require more complex collateral solutions relating to their derivatives and securities finance transactions stemming from stricter rules around issuer concentration, and the re-investment as well as custody arrangements supporting these activities. This will require coordinated effort between the funds and their providers as well as counterparties.

Tomkinson: As the ESMA guidelines are adopted and the rules become transparent, there is an expectation that the current trend towards increased UCITS fund investment in open and short-term maturity triparty/repo/reverse repo transactions will continue to increase.

In practical terms, this increase in short maturity repo volumes is likely to be accompanied by an increase in the provision of tailored products by the triparty programmes that are designed to support the UCITS fund's specific needs, for example, improved reporting mechanisms.

If there is a significant increase in the flow of short-term funds into triparty repo, it is possible that rates at the short end may be distorted lower as there would be an over-supply of cash providers as UCITS funds target the ultra-short end of the curve for recall purposes.

In the short term and especially in the context of the current economic and investment climate, the move to short-end reverse repo cash investments supports a conservative investment approach and provides firms with one of the safest havens for short-term cash investments. However, it is expected that as funds become more adventurous over time and competition for returns on investment increases, inevitably the returns offered by short-term reverse repo will not be sufficient to satisfy required returns, and alternatives will be sought.

Awan: For securities lending, the rules are two-fold: (i) return all revenues from lending to the fund; and (ii) recall the assets at any time or terminate the transaction. On the first point, we are not affected as we perform an operational and administrative role for our clients. On the second point, as a triparty collateral management agent, we manage all types of securities lending and repo transactions—open-ended, one-day or term of any length.

Everyone knows that overnight loans are not what the market wants in securing stable and profitable trades for both sides of the transaction. As for the return of all lending revenue to the funds, the regulators need to take into account that this market has suffered declining volumes since the start of the crisis and historically has not operated with attractive cost-income ratios.

We also fulfil a key requirement for collateral that is received by UCITS funds under the new ESMA rules in that the collateral must be diversified, with concentration limits placed on different asset types. Our triparty collateral management service manages this form of diversification at incredibly granular levels automatically.

Repo and securities lending market access limitations in ESMA's guidelines will affect the way UCITS funds manage their cash positions. Repos and reverse repos are currently used as a means to adjust UCITS funds cash positions in a safe, flexible and profitable way. They are also used to re-invest cash collateral received through securities lending arrangements. Demand to borrow securities and to fund transactions on a term basis has increased with the development of new liquidity requirements under new prudential regulations. Limiting access of UCITS funds to term lending and repo transactions may place them at a distinct disadvantage relative to non-UCITS funds.

Another bone of contention is Basel III—who will benefit from this regulation and who will lose out?

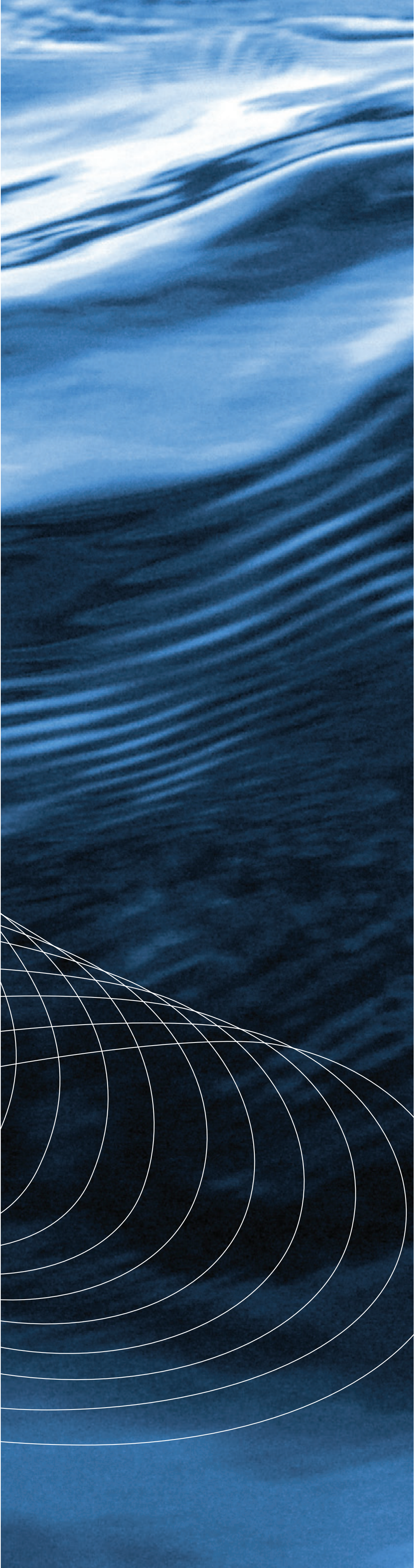
Iain Colquhoun: Europe's Basel III fundamentally changes the way in which collateral is treated. The capital impact of Basel III on repo transactions may well take a good deal of speculation out of the market. It would seem that the days in which repo was used as a tool to express a view on interest rate direction are over. The core function of repo as a firm financing tool and a way in which to gain a collateralised return on long cash balances will continue, but transaction frequency and churn will reduce in the market. Fundamentally, there are four sorts of repo participant:

1. Market makers that are largely operating within large banks with a core firm financing function. This role will continue, although it may be that the risk-taking element of the role becomes segregated and concentrated in off-balance sheet product.
2. Leveraged institutions—typically hedge funds—that will have to continue to finance their firm positions. It may be that the cost of finance to these sorts of institution rises as market makers within banks become more concerned with the careful management of balance sheet and capital resources. This will increase the importance of varied relationships with a variety of providers. The days of financing through two or three providers are likely to be over. The dynamic of the client relationship changes a little in this scenario.
3. Long cash balance holders—as in the wider world, the cost of banking services is a topic of conversation. In a global zero interest rate policy scenario, the value of collateralised borrowing becomes higher. Fundamentally, the concept of negative interest rates for the investment of cash balances against high grade collateral will come to the fore, which again represents a fundamental shift in the dynamic of the client relationship. The large central bank/sovereign wealth funds institutions will invest cash in the market to the extent that they have to place funds. Longer term trades at lower rates, or indeed negative rates, become less attractive, so the market may well shrink and become more short-term.
4. Buy-to-hold investors/securities lending programmes—the use of the repo market to generate incremental revenue may well be hit hardest in the new world. The collapse of spreads between asset classes reduces the potential for revenue generation within this sphere and the imposition of Basel III makes the speculation that drives the repo specials market less profitable. Even though the Global Master Securities Lending Agreement generally produces a more favourable capital/balance sheet treatment, if trading repo is fundamentally more expensive, the potential to generate incremental revenue from switching assets becomes less likely.

Stefan Lepp: On a mid- to long-term basis, the entire financial industry will benefit from Basel III. This is due to the fact that Basel III will force financial institutions to further strengthen and stabilise the overall capital frame of each individual firm leading to a more sustainable industry. Basel III can be seen as one important building block that is needed to bring back trust to the industry and therefore building the basis to re-activate essential industry activities that have suffered in the past, such as, interbank-financing activities as well as B2C financing activities.

Awan: Any institution that does not utilise capital efficiently will lose out. In the case of securities lending agents, and custodian banks in particular, offering indemnities to beneficial owners against borrower defaults may come to an end under Basel III or it's going to cost them capital to carry on offering this indemnity. If beneficial owners cannot be indemnified and decide to leave securities lending programmes, the whole market will lose out as liquidity disappears. The winners will be those providers that can offer beneficial owners counterparties that are highly rated (at least AA), giving them a safeguard against borrower default and where the beneficial owner has immediate and unfettered access to the collateral against their loans. Euroclear offers precisely this set of risk mitigating factors and strength in its securities lending programme.

Rivet: Basel III introduces higher capital levels, reduced leverage targets and better liquidity management, and investors and counterparties are imposing market discipline through which better capitalised banks are rewarded with (in relative terms) better financing ability and lower cost. An additional consequence of Basel III will be the incentive to manage collateral effectively and efficiently to reduce counterparty/operational risk capital requirements.



Separately, the liquidity requirements, and specifically the liquidity coverage ratio, appear to limit banks' ability to rehypothecate. The need to efficiently manage collateral points to the strength of an outsourced solution, with one agent centralising collateral management. As a collateral agent, we help clients to mitigate counterparty, operational and credit risk through sophisticated collateral allocation and optimisation across all obligations. Maximising asset utilisation—more critical if high quality collateral is scarce—enhances performance and limits the need for, and associated cost, of collateral transformation.

Is transparency of repo haircuts and repo levels a good idea?

Tomkinson: Currently, there are limited variations in trading arrangements between counterparties and the service offerings among the triparty repo service providers. Given the limitation in the eligibility of collateral and the inevitable short maturity of repo transactions, the cash-taking counterparties to UCITS funds will have limited opportunities to offer significant variations in transactions terms from one fund to the next, and so it is expected that any increase in transparency, although likely to lead to a greater level of standardisation, will not expose significant variations in current trading arrangements.

Colquhoun: Information is key in any market, and it is incredibly helpful when pricing any trade. Knowledge of the OTC market in standardised terms is already widely available and this is probably sufficient. Repo at the end user level is not a homogenised product. The levels at which a trade is transacted and the haircut that is charged very much depend on the relative standing of the two counterparts and the collateral that is involved. The information that a bond has traded in three months at 0.25 at 0 percent haircut between an A-rated bank and a AAA rated sovereign wealth fund is completely irrelevant to a small institution with low capital reserves and no credit rating. The bespoke nature of repo and the impossibility of a one-size fits all trading level is what keeps the professional trading and sales force valuable in the current market.

Awan: Transparency in the repo market is paramount for its success and development. Primarily, an interbank market, the repo market is gradually expanding to other segments of the financial industry and beyond. New entrants, and particularly cash investors, are looking at the repo markets to secure their exposures as the unsecured market has practically shut down following the financial crisis.

While some liquidity may still be available at the very short end of the curve, any maturity beyond one month is of no interest to most of those investors. Although they may have longer liabilities, these cash investors are forced to roll over short-term transactions and do not fully exploit all of their available resources. This is currently the case for corporate treasurers that typically have liabilities across the entire money market curve. Migrating longer-term liabilities to the repo market is a suitable solution to match the tenor of the investment with the liability.

A lot of these newcomers are looking at triparty collateral management solutions, such as those that are offered by Euroclear. Our experience with new repo cash investors shows that the lack of information, including robust trading data, is significantly slowing down the growing breadth of repo market counterparties.

What would be the impact of converting these balances into repos? Investors are asking, 'how much yield, if any, do I have to give up?' and 'what level can I expect for a three-month repo?' Apart from requesting quotes from dealers, nothing meaningful is available to them.

The International Capital Market Association has made tremendous efforts in increasing transparency by surveying the market on a bi-annual basis. The survey data is used by many banks when soliciting cash investors in repos. But trading data is still missing. The recent announcement from BrokerTec and MTS about the launch of the RepoFunds Rate daily repo index for eurozone sovereign bonds can only be seen as good news. Even if it only covers general collateral overnight trades in euro, it is a major step towards transparency. Investors will be able to benchmark their overnight transactions and estimate the term of non-general collateral yields by defining the spread over the benchmark.

Rivet: We support recommendations to increase transparency. In terms of approach, our preference is to start with firm surveys (harmonised by regulators across all jurisdictions to the extent possible), rather than a global trade repository. Should the decision be made to use a trade repository, much more analysis needs to go into the development of trade repository data points and what type of entity (industry owned or otherwise) would provide this utility. Our experience with derivatives has shown that the cost of building a repository is significant and it would be critical to ensure such a utility is done correctly.

We also support disclosure to regulators, particularly with regards to transparency on haircut levels, but strongly believe that the information that is shared/published more broadly must be aggregated and not disclosed on a granular basis. We do not believe that a disclosure of haircut levels in each firm's financial statements is appropriate as this is proprietary information that should not be shared broadly. If we share with the regulators, they can police any difficulties observed by individual firms without affecting the competitive dynamics by disclosing information publically (that our competitors can and would see) on these haircuts.

What benefits do you believe collateral outsourcing can bring to your clients in the near future?

Tomkinson: In developing a collateral management capability, the first decision institutions face is the fundamental choice between an in-house capability (self-build or package) and an outsourced solution in which a third party is employed to provide a collateral management solution. The benefits of an outsourced solution are numerous and most importantly include rapid speed to market—the ability to have a relatively sophisticated and audited solution in place within a few months; a solution which is continually being updated in response to market changes.

The outsourced collateral solution is regularly offered alongside other clearing and settlement options and is often integrated with custody solutions, cash reinvestment capabilities, repo and securities lending solutions. The benefits of a single service provider relationship across a wide range of solutions are often highlighted and there is no doubt there are important synergies and economies achieved by using a single service provider with a single point of contact for the client across a number of client clearing and collateral management solutions.

A number of institutions that are increasing their collateral management focus are considering the outsource solution as a first step prior to a long-term collateral management decision. This is in order to quickly implement a collateral management capability without the full financial commitment required to support a large internal infrastructure build project. This also allows internal expertise to be built up while allowing the market changes to become 'bedded-in' prior to committing to the significant financial cost of implementing a long-term collateral management solution.

The benefits of employing an outsourced solution, however, need to be weighed up against the dependency on a single institution providing a full range of securities processing services. There are few firms able to provide a full capability across all service areas, and even fewer possessing high levels of automated integration of the collateral management function within the custody and clearing services.

Lepp: Firstly, we have to differentiate between the different customer segments.

For customers such as agent banks and global custodians, collateral outsourcing is leading to significant benefits in the sense of being able to offer an urgently required functionality within a short-time-to-market time frame at a low cost. This is the case under the pre-condition that the individual agent bank or global custodian does not lose control (and revenues) on the leveraged collateral (custody positions) and as long as the global custodian and the agent bank remains the single point of contact for its underlying customers. Understanding this key requirement and in the frame of strategic partnerships, Clearstream has established a model that considers the individual needs and requirements of the agent banks and global custodians in the frame of its collateral management outsourcing service, Liquidity Hub Connect.

For infrastructure providers such as central securities depositories (CSDs), monetary authorities, exchanges and other service providers offering post-trade/custody services, collateral outsourcing is becoming more and more important as long as certain criteria can be fulfilled by the respective collateral management service provider. Time-to-market, development costs, maintenance costs and the need for extensive expertise means that more and more infrastructure providers are considering making a strategic partnership in the space of collateral management.

Given their nature, infrastructure providers have to fulfill very strict local rules when it comes to offering services in cooperation with a strategic partner. For infrastructure providers, it is key to be able to offer any new service under existing local laws and regulations. Existing contracts have to remain intact and local jurisdiction cannot be affected and/or changed. Even the account structure within a local infrastructure provider needs to remain untouched—in other words—it is not possible for most infrastructure providers to accept a transfer of domestic collateral positions to a collateral management service provider, even if it would be willing to open accounts in the accounting world of the local infrastructure provider. This is mainly driven by the need of the infrastructure provider to keep control of the respective assets (collateral) and to be able to have immediate access to the collateral in case it is needed.

Given the open architecture of Clearstream's Global Liquidity Hub, we have been able to fulfill all of the individual and strict requirements of infrastructure providers in the frame of our Liquidity Hub GO functionality. The fact that Clearstream has been able to already enter into strategic partnerships with the local CSDs/infrastructures in Brazil, Australia, Canada, South Africa and Spain indicates that the open architect philosophy combined with seamless white-labelling functionalities works for the industry. Our strategic partners confirm that their estimation on an 'own build' strategy would not match the time-to-market requirements and at the same time would incorporate a massive one-off investment followed by high maintenance costs.

Going forward, there will be even higher demand for collateral outsourcing in line with the changing requirements. This is not only driven by the growing size and number of exposures (for example, OTC central counterparty exposures), but also by the demand for balance sheet friendly (collateralised) trading.

It is also essential to understand that collateral outsourcing does only lead to real benefits for customers when the service proposal allows for the consideration (identification) of several (fragmented) collateral pools irrespective of time zones without jeopardising or eliminating proven relationships. At the same time, it allows for a seamless exposure coverage across multiple trading and clearing venues.

In this respect, we trust that in the frame of Clearstream's Global Liquidity Hub and all related sub-streams, our customers across all layers will massively benefit from our collateral outsourcing service, which is constantly adjusted towards new market requirements, regulatory changes and other market reforms.

Awan: Collateral outsourcing brings immediate benefits, as it allows clients to focus on the economics of their trades and leave the operational burdens to a specialist. At Euroclear, we have been delivering triparty services for nearly 20 years and thanks to the continuous dialogue with our customers we have added additional services to optimise collateral usage.

In the near future, we will add a new dimension to triparty collateral management by giving clients the option to use a new securities inventory management service, in addition to our triparty collateral management services. Open Inventory Sourcing, which was developed in partnership with domestic agents such as BNP Paribas, will automate securities inventory flows between mutual customer accounts that are held with their custodian and Euroclear Bank. This technology will dramatically increase the mobility of collateral between domestic markets, where clients hold assets, and Euroclear Bank, where we finance them. We want to give clients the choice as to where to hold their assets while offering them the possibility to finance them with Euroclear's triparty services.

Rivet: Outsourcing collateral management delivers significant benefits across the spectrum, including an adherence to emerging regulatory requirements. As a leading collateral agent, we offer clients expertise and compliance with the new regulations.

Our flexible and scalable operational infrastructure helps clients to meet the increased demands for collateral segregation, clearing activities and reporting that are required by the regulators:

- Centralised collateral management—the commencement of mandated clearing for most swap activities will drive tremendous growth in collateral needed to meet initial and variation margins, along with increased complexity. By choice or by regulation, institutions will collateralise more transactions, work with multiple clearing brokers or clearing organisations, and hold assets at multiple custodians. Centralised collateral management will simplify this complexity. It allows for assets to be deployed efficiently against all obligations, in order to support financing objectives, limit costs and reduce risk.
- Efficient and risk-controlled infrastructure—clients will be able to concentrate on optimising their collateral usage when they can rely on a collateral agent that significantly and continuously invests in technology and operations to achieve scalability and efficiency. Among other benefits, our triparty collateral management infrastructure delivers collateral centralisation—J.P. Morgan provides a holistic and fully global integrated view of assets and obligations across multiple portfolios and client/counterparty legal entities. We are extending that capability to include a clearing and custody-agnostic view of all assets, even those held at third-parties, to allow clients to manage their collateral from a single virtual longbox, with sophisticated 'what if' pre-trade analysis and analytics.
- Collateral optimisation—clients facing increasingly scarce assets needed to meet margin requirements will seek to use agent collateral managers with the technology algorithms that are capable of assigning collateral to various counterparties in the most efficient order. By utilising less valuable assets to meet certain obligations, a client will be able to secure their most valuable assets to meet obligations with restrictive collateral requirements. Efficiently optimising assets will allow institutions to limit the need for—and potential cost of—collateral transformation solutions.
- Clearinghouse triparty solutions—triparty functionality presents an automated solution to allow futures commission merchants and clearing brokers to secure obligations with their multiple clearinghouses and/or to collect cleared margin from their clients. The triparty structure allows for an agent collateral manager to collect margin due and lock it up in accounts belonging to the secured party (either the clearinghouse or the clearing broker). We currently provide this service to CME Clearing Europe.
- Rehypothecation—similarly to collateral optimisation, clients will seek to employ all of their eligible assets where permissible, including counterparty assets pledged to them, to meet their higher margin requirements. Collateral agents able to support the rehypothecation of pledged assets will provide an invaluable source of financing.
- Economies of scale—the use of a triparty agent vastly reduces the operational overheads of supporting collateral exposures on a bilateral basis. Bilateral collateral management is operationally intensive and is less scalable due to the requirement to pre-agree trade movements, test eligibility and monitor trade settlement.

The triparty repo model is under reform in the US, but all signs point to its popularity and a knack for getting results. What are the benefits of this model?

Lepp: Triparty repo has been and remains an important diversification tool, particularly in line with all upcoming regulatory changes. However, there exists a significant difference between the US triparty repo model and the European triparty repo model when it comes to the individual risk scenarios. This has been identified in the US and the industry is in the process of addressing this topic.

Colquhoun: The triparty repo model in the US is the most developed in the world. Even in terms of systems infrastructure, it is light years ahead of most banks in Europe. Clearstream's triparty product in Europe is very advanced and offers a great deal of flexibility and strong information flows (much more so than its competitors), however, my impression is that large portions of the market do not process this data in the same way as our US counterparts.

Tomkinson: We should recognise that the US model is undergoing change and that although the European model is now relatively mature, it too is very much an evolving solution and is continuingly being adapted to respond to market change and specific user needs. The market changes in response to the events of September 2008 have resulted in a renewed focus on the triparty product and the solutions that it can provide.

Although firms offering triparty solutions appear generally to be reluctant to declare definitively their future capabilities, the development of triparty into a quadparty mechanism that supports both CCP clearing and end-clients appears to be a clear focus for many of the triparty service providers.

Triparty is essentially an outsourcing solution that provides eligibility and sufficiency checks on collateral, combining this with the automated generation of collateral settlement instructions. Clients that utilise a triparty solution can avoid the burden and costs that are required to build an in-house collateral capability, and can benefit from a tried-and-tested market standard collateral solution.

Rivet: The target model for US triparty repo is the result of months of collaborative sessions with senior leaders from broker dealers, asset managers, the two clearing banks, the Fixed Income Clearing Corporation and regulators. The model is designed to address key systemic risks that have been identified by regulators and the market participants. Key benefits include increased transparency, both to the volume and composition of repo activity and also to the stability of funding being raised. Additionally, the new model creates a more streamlined and predictable settlement process, accelerating the time in which repos are settled and availability of proceeds.

Finally, the new model dramatically reduces the amount of credit that is required by the clearing banks to support repo activity. Significant steps have already been taken towards achieving those goals.

The strength of the triparty model is evidenced by the fact that, even after three years of reforms and substantive market changes, the US triparty repo market continues to increase in size. In fact, the US triparty repo market is up $400 billion—nearly 25 percent—since the middle of 2010, when reforms first began being implemented. This clearly demonstrates the value of triparty repo to both dealers and cash investors. We expect to see continued growth, particularly as reforms draw to a close in 2013.

How is Asia getting on with the triparty repo model—will the region move away from bilateral?

Rivet: Triparty repo is being implemented within the Asian markets more slowly than anticipated but the potential remains huge. The size of the Asian repo market is approximately $1 trillion, with the majority outstanding concentrated in Japan and Australia. One of the biggest challenges for repo market expansion in the region seems to be the lack of robust collateral management systems and infrastructure that are available to local market participants. However, the outlook is promising, especially for triparty services, which ideally addresses the system/infrastructural gap.

Local regulators are also keen on the development of the repo market because of its ability to foster secured liquidity. The Hong Kong Monetary Authority (HKMA) has recently begun to lead the way, partnering with triparty agents, such as J.P. Morgan, to encourage international entities to leverage their securities inventories to access locally settled currencies (CNH, EUR, HKD and GBP) from domestic banks.

Not only is local cash attractive to international investors, but also there is significant demand for Asian assets, particularly government bonds (for example, Japanese, South Korean and Australian bonds). One reason is their potential high collateral eligibility, assisting international investors in meeting regulatory requirements, for example, the LCR calculations under Basel III. The majority of repo trades are performed on a bilateral basis so the market is still in the early stages of evolution. One way to estimate the potential growth is as a measure of GDP. The volume of repo trading in developed markets such as the US and Europe is around 30 to 40 percent of GDP, but in Asia Pacific it is only around 8 percent of GDP. Therefore, given infrastructural initiatives such as the HKMA's cross-border collateral management programme, the availability of local collateral, and the interest in local currencies such as RMB and AUD, we expect to see significant future growth both in triparty and in the overall repo markets in Asia.

Lepp: We observe a growing demand for triparty repo in Asia. This is mainly driven by dedicated regulatory changes, the need for financing alternatives within Asia but also cross-market, the need for higher efficiency and transparency, and, last but not least, the demand from existing and potential counterparties outside of Asia for triparty repo. We do not expect the region to move away from bilateral repo on a short-term basis, however, we do expect an ongoing shift from bilateral repo to triparty repo for the given reasons in the coming years.

Awan: Although Asia has had partial immunity from the financial crisis, there is little doubt that Asian financial institutions will be more involved in repos and other secured transactions because collateralisation is a core pillar for the development of a resilient global financial market.

Until recently, repos were almost exclusively transacted bilaterally, but we are witnessing growing interest from an increasing number of Asian customers to leverage our triparty services, primarily to outsource the burdens of collateral management and to access the international community of cash investors that are actively using our triparty services. Bridging the gap between Asia and the international community is expanding their liquidity resources and opening new horizons for them.

The recent announcement of the first RMB repo transacted through our triparty link with HKMA in Hong Kong is a good example of the future landscape. Partnering with domestic infrastructure providers and agents is key in providing our mutual clients with the benefits of accessing global counterparties and increasing their liquidity management options.

Linking counterparties and increasing collateral mobility are major themes for the years to come. Moreover, liquidity resources will have to be exploited to their full potential. Our day-to-day job is to ensure our clients have the infrastructure that will enable them to achieve these types of objectives.

Colquhoun: This was a topic of conversation at the GSF summit in Singapore last year and shows no sign of developing at pace. The sheer breadth of collateral traded in Asia lends itself nicely to triparty and the reduction in operational overhead is attractive to many small market participants. For this reason, there will be an explosion in triparty volume as more participants enter the repo market. At present, compared to the relative size of the market, the Asian repo market is quite small. When the growth comes, it will come in triparty.

Tomkinson: Asia has historically been a region in which the uptake of triparty repo has lagged behind Europe.

Collateralised solutions have not played such a big part in investment solutions, however, the triparty service providers have been focused on developing the market in Asia. **SLT**

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Video killed the cellphone star

Oscar Huettner, product manager of BondLend, comments on cellphone trends. How does Nokia's share price and loan values reflect the dynamics of the global cellphone market?

On 18 December, IHS Media Relations reported that for the first time since 1998 Nokia had slipped to number two in worldwide cellphone shipments. In 2012, Nokia was overtaken by Samsung and saw its market share slip from 30 to 24 percent, while Samsung's rose from 24 to 29 percent. While in isolation a loss of market share of this magnitude is cause for significant concern, it is in reality the continuation of a multi-year trend that has seen Nokia's market share fall dramatically from almost 50 percent in 2007 to its current level.

Prior to this slide, RIM was Nokia's closest competitor with a market share of less than 10 percent. In the short span of five years, Nokia has gone from the dominant name in cellphones to a position where it is playing catch up to not one but two adept competitors; Samsung and Apple.

The pivotal date in this saga was on 29 June 2007, which was the day that Apple launched its first iPhone and with it the smartphone revolution. In 2013, smartphones will for the first time comprise a majority of the cellphone market. Apple continues to lead that market at the high end, rolling out successive generations of its signature product, each with previously unimagined electronic wizardry, while Samsung proves a nimble adversary by producing dozens of models that are intended to serve the different needs of various market segments.

The fortunes of Nokia are borne out in its stock price. Ignoring the lofty levels that its shares attained in 2000 when it like all other 'tech' companies was caught up in the internet bubble, Nokia's high water mark was 6 November 2007 when it closed at €28.60 per share. Since then, its shares have been caught in a multi-year decline that reached a price of €1.37 per share on 17 July 2012 before they recovered modestly to a price of 3.16 on 19 December 2012. RIM, which was the first competitor to capture significant market share from Nokia, has seen its fortunes and share price follow Nokia on the same trajectory, from a peak of C$149.90 per share on 18 June 2008 to a low of C$6.18 per share on 24 September 2012. Meanwhile, both Samsung's and Apple's charts have shown almost a mirror image of Nokia's and RIM's.

Over this same five-year period, the global securities lending markets have experienced their own dramatic changes. The loss of several large market participants, the contraction of the equity and fixed income securities finance market, record low interest rates, and the specter of increased regulation have dominated the market press and various securities lending conferences. Market movements and the inter-related demand for securities that these movements cause are often obscured by the challenges lenders and borrowers have confronted in recent years. Meeting these challenges while remaining focused on the ebb and flow of the global securities lending market has been daunting to say the least. So what have we seen from the securities lending market as it relates to the global cellphone market and what conclusions can we draw from it?

Focusing on the cellphone market over the course of the last six months, Nokia has seen a bottoming out of its share price. From mid-July to mid-December, Nokia's shares have more than doubled. During that time we saw the borrowing costs of Nokia shares peak at 554 basis points on 31 October. From there we have seen a steady decline to 231 basis points on 18 December. On loan quantity has fallen from 831 million shares to 632 million shares and utilisation from 92 percent to 86 percent. This reduced level of market shorts and subsequent reduction in lending fees may reflect the modest success of Nokia's new Asha and Lumia products or it may be influenced by Apple's missteps with its map app; it is hard to tell.

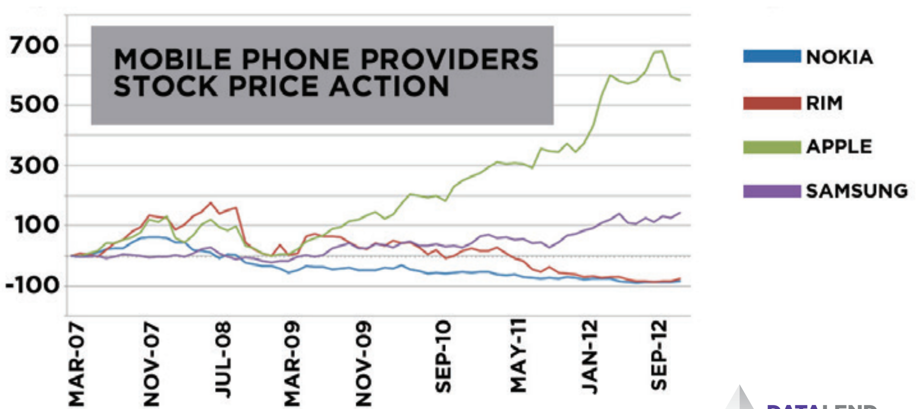
We have also noted a significant correlation between Nokia's equity short base and the short base in several of its corporate bonds; most notably the Nokia 5 on 4 February 2014 that has been in consistent demand. For most of the autumn we saw utilisation in the high 90s, peaking at 97 percent on 8 October before coming off dramatically to approximately 37 percent. Despite this reduction in demand the bond remains 'tight', currently trading in the 250 basis point range down from 300 basis points.

Looking at the borrowing costs of other stocks in the cellphone market place, we have seen RIM trade 'tighter' as Nokia has shown a modest recovery. RIM's average fee has moved from general collateral territory to hot over the past month, increasing from 55 basis points to more than 250 basis points before settling back to the 200 basis point range. On loan quantities have increased from 53.2 million shares to 64.7 million shares with utilisation reaching 87 percent of available inventory. This short interest seems at odds with the company's share price, which has more than doubled over the past 90 days, but the share prices may reflect the upgrade of the stock by several respected analysts. RIM's new line of smartphones will be unveiled this month and we will see whether the bears are right.

Apple's short base is virtually non-existent despite the decline in its share price from $704 per share to $526 per share over the last three months. We see utilisation of approximately of 0.5 percent. Samsung's is also insignificant at 0.69 percent. Unlike Nokia and RIM, both Apple and Samsung produce a broad range of products beyond cellphones and are somewhat insulated from the dynamics of a single product line. What may be a bit surprising is that the market does not seem to have established any significant short positions around the ongoing patent litigation between Apple and Samsung.

The current opinion of the average consumer on the street seems to be that Apple is poised to continue as the market leader in cellphone gadgetry while Samsung grabs market volume at both the bottom and top of the market by offering a broad spectrum of products to fill various needs. Nokia and RIM appear to have been written off by the general public, but if history is any guide, the cellphone market could look as different in five years' time as it does now when looking back to 2007.

Securities lending figures do not lead the market, but they often can tell a story about broader market movements. Has Nokia turned the corner in the area of product development? The easing of demand for its shares and bonds seems to support its recent price action.



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Festive cheer for short sellers

As all eyes turn to UK retailers ahead of updates about the crucial Christmas trading period, short sellers have been busy picking winners and losers. Alex Brog of Markit Securities Finance takes a look

The UK economy has been buoyed by the FTSE 100 index having surged past the symbolic 6000 mark and by better-than-expected manufacturing activity.

The Markit PMI survey revealed that UK manufacturing activity surged to a 15-month high at 51.4 in December 2012. A reading above 50 indicates an expansion in activity.

Attention now turns to the nation's retailers to assess how consumers have responded over the festive season.

Fragile consumer sentiment

Data available so far, such as the Markit-compiled Visa expenditure statistics, suggests that retailers had a tough December 2012, with spend running at the same levels that were seen a year ago.

Once again, aggressive discounting has been widespread in the lead-up to Christmas to stimulate sales. However, while this may have helped shift stock, it bodes ill for margins and profits.

"Retailers face an ongoing battle against consumers who are worried about the economic outlook and job security, while also being squeezed by inflation that continues to run ahead of pay growth. A tough 2012 looks set to be followed by an equally challenging 2013," notes Chris Williamson, chief economist at Markit.

Early indications from stronger retailers such as Next, Liberty and John Lewis have been positive, but short interest among the nation's retailers is far higher than average.

Retailer short sale targets

Average short interest across the FTSE All Share index is low at only 1.2 percent of total shares outstanding on loan. However, demand to borrow the 29 retailers in the index is three times the average at 3.6 percent.

Traditional retailers with limited online offerings see the heaviest demand to borrow (see table).

Morrison under pressure

The Financial Times highlighted that Jefferies, broker to WM Morrison, expects the grocer to experience a "weak" performance in January, with trading having deteriorated at a faster rate over the Christmas period than during Q3.

The grocer, which is hindered by the lack of an online offering, has seen short interest rise by 40.9 percent over the past month alone to an annual high of 4.3 percent of the total shares (if borrowing demand around the dividend record date is excluded).

Most shorted

Perennial short Home Retail Group tops the list with 20.4 percent of its total shares on loan, although this is down on the high of 24 percent that was seen at the end of July 2012. Short interest has surged in the group, which owns discount chain Argos, in the last two months of the year despite the share price staging a modest recovery from the annual low. With almost three-quarters of the supply of shares out on loan, it would be difficult and expensive to short any more of the company.

Loss-making grocer Ocado lies in second place with 13.8 percent of its shares on loan. The company has been targeted by short sellers since its flotation and stands out from the other heavily shorted retailers given its sole focus on e-commerce.

Shorts began to cover their positions from the record high of 18 percent and this gained momentum in late November 2012 after the shares rallied following better than expected sales and news that the company had extended its credit lines and issued new shares to fund construction of a warehouse facility.

Like Home Retail, almost three-quarters of the available shares are on loan, meaning that it would be hard and expensive to short any more of the company.

Despite disappointing trading updates in the final quarter of 2012, short sellers have covered their aggregate positions in the bastion of the UK high street, Marks & Spencer. Demand to borrow the shares peaked in April at 6.4 percent and short interest now stands at less than half that figure at 3 percent of the total shares. It will be interesting to see how short sellers respond to the latest trading update.

Short covering in electrical specialists

Struggling electrical retailers Dixons and Darty have both seen shorts cover their aggregate position by just under a third over the past month. However, they still remain heavily targeted by short sellers. Dixons sees 7.5 percent of its total shares on loan while Darty sees short interest standing at 5.7 percent—both much higher than the average across the sector. **SLT**

Alex Brog
Director
Markit Securities Finance

Short Name	% Total Shares on Loan	Change over 1 Month (%)	Utilization
HOME RETAIL GROU	20.4	23.4	74.3
OCADO GROUP PLC	13.8	-6.5	73.9
WH SMITH PLC	13.1	-5.7	49.1
CARPETRIGHT PLC	11.9	-20.0	73.0
DIXONS RETAIL PL	7.5	-27.3	34.7
MOTHERCARE PLC	6.6	-4.5	38.4
DARTY PLC	5.7	-30.5	37.6
WM MORRISON SUP	4.3	40.9	15.1
MARKS & SPENCER	3.1	-3.7	12.4
DIGNITY PLC	3.0	9.1	10.6
HALFORDS GRP PLC	2.4	-40.1	9.1

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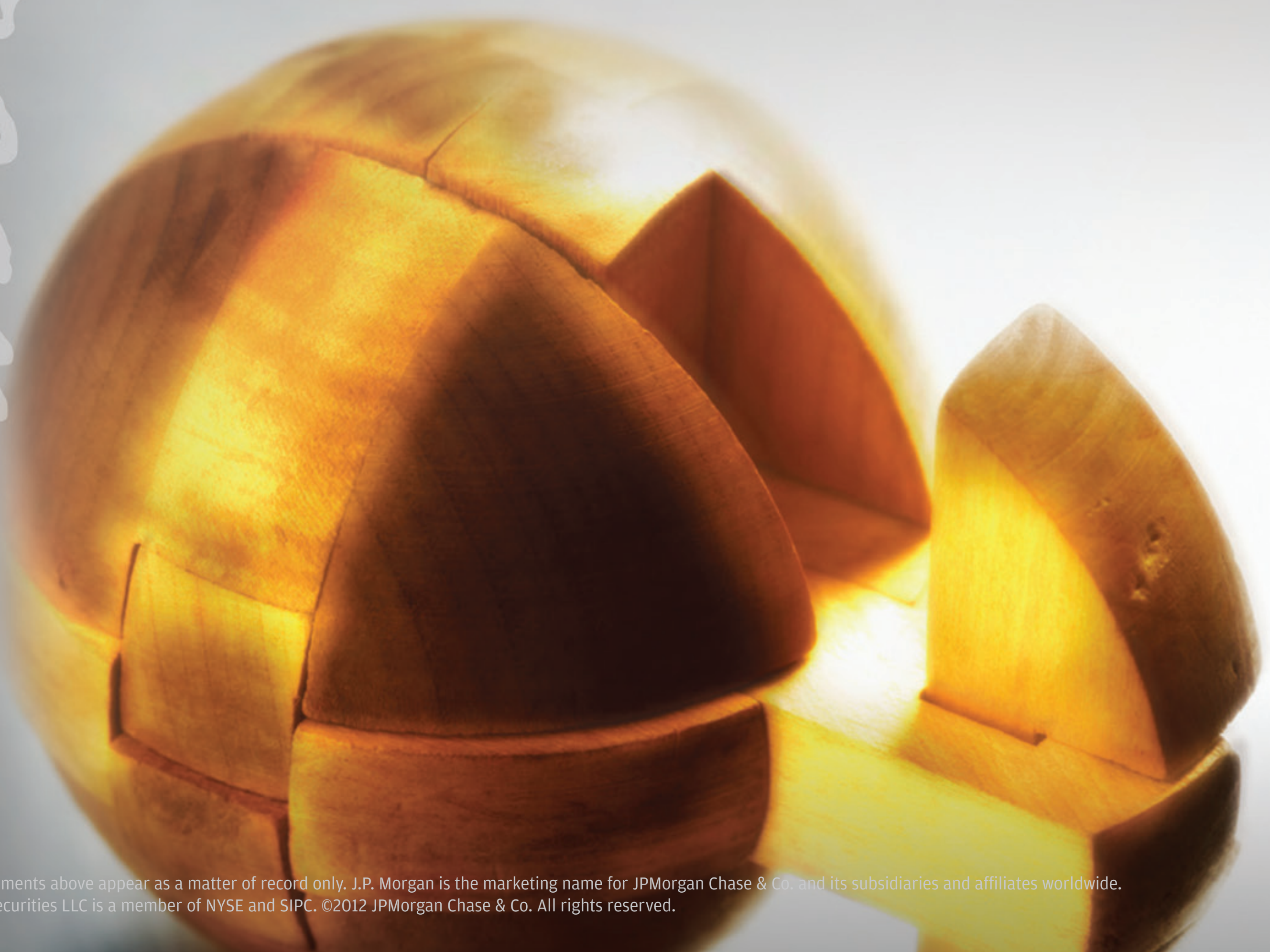

Industry appointments

Frankfurt-based consultancy and software development house Comyno has hired **Andrew Chaplin** as a managing partner in London.

Comyno designs and implements infrastructure for securities finance businesses.

It is now looking to expand after completing a Martini/Apex migration and supporting its clients in Frankfurt with establishing and integrating trading counterparties in Eurex Clearing's new securities lending central counterparty (CCP) service.

Before joining Comyno, Chaplin worked in London for more than 15 years at vendors and integrators specialising in solutions for OTC markets, including repo and securities lending at Framesoft and pricing/valuations of OTC derivatives and associated collateral at GoldenSource.

Steven Scholl has left Royal Bank of Scotland to join National Bank of Canada Financial.

The director and head of securities lending in the Americas at RBS began leading National Bank of Canada Financial's US and Latin America securities lending business on 7 January. He is based in New York.

Scholl previously worked as a vice president and agency lending trader at Credit Suisse in New York.

Rhode Island's general treasurer, Gina Raimondo has appointed **Anne-Marie Fink** as the new chief investment officer/deputy treasurer of finance responsible for managing the state's $7.3 billion pension fund.

Fink previously held the role of managing director and portfolio manager at J.P. Morgan Private Bank. She will be replacing Kenneth Goodreau, who has left the role after four years.

BNY Mellon has made **Timothy Keaney** CEO of investment services as the firm aligns its asset servicing, corporate trust, depository receipts, global markets, global collateral services, broker-dealer services and Pershing businesses under his leadership.

The new role came into effect on 1 January.

Keaney was CEO of asset servicing and retains his role of vice chairman under his new position. He continues to report to BNY Mellon chairman and CEO Gerald Hassell.

Before joining BNY Mellon, Keaney worked at Deutsche Bank where he had management responsibility for sales and client management for custody, asset administration, performance measurement, asset management, funds transfer and trade finance activities.

Old Mutual Global Investors has hired **Donald Pepper** as managing director of alternative investments.

The asset manager was formed in April when Old Mutual Asset Managers UK and Skandia Investment Group merged.

Pepper joins Old Mutual from TT International where he was investment director for hedge funds. He started out at Goldman Sachs in 1987, where he spent 16 years in fixed income and prime brokerage, before joining Merrill Lynch in 2003 as managing director of its European prime brokerage business.

In 2008, Pepper became head of alternatives at New Star Asset Management. He later became head of hedge funds at Henderson Global Investors, which acquired New Star, until he joined TT International in 2010.

In order to drive forward its prime finance business and create a fully integrated division, Citi has created a new role for **Alan Pace**.

Pace will be the new global head of sales and client experience and will be charge of prime finance sales, including securities lending and prime brokerage.

In the Americas, David Murphy will assume responsibility for prime finance, relocating to the US, having been recruited from Deutsche Bank.

Citi is currently considering candidates for Murphy's replacement in Asia.

Ralph Segreti will be the new head of agency derivatives origination at Barclays, with Adam Law taking over his previous role as inflation product manager.

Segreti's new title is head of agency derivatives services origination for EMEA, within the bank's prime services division.

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His previous role as global inflation product manager will be filled by Law, who will in turn be assisted by Murray Royden-Turner, the new offshore product manager for the interest rates businesses. **SLT**

...Raymond Vuyst

SLT and Raymond Vuyst, managing director for continental Europe business at Synechron, catch up after the Christmas break to discuss how IT meets securities finance, cooking and why everybody may (or may not) love Raymond

How did you get into the securities lending industry?

After studying financial economics at the Vrije University of Amsterdam, I started working for VSB Bank (part of Fortis group). One year later, I switched internally to the cash management department of MeesPierson (part of the Fortis group). Alongside this, I did some projects with the global securities lending and arbitrage (GSLA) department and the custody/clearing department. I really felt at home with the mentality of the fast growing and very ambitious GSLA unit. Apparently, the management of GSLA recognised my no-nonsense and can-do mentality, and asked me to join them in 1999. My first assignment was to fully automate the manual settlement process of Global One.

To what extent has working in the industry met your expectations?

I always expected the financial markets to be dynamic and opportunistic and at GSLA that was definitely the case! We were growing and expanding so fast year after year that it was a real roller coaster and surpassed all my expectations.

In the past, we had an autonomously operating department. All possible activities were done within this department, which created an enormously strong team spirit, large business revenues and very short time-to-market IT projects.

Due to multiple internal and external factors, this all changed over time for most participants in the financial markets, including GSLA.

What do you see as the biggest challenge facing the industry right now and why?

Spending your resources and budget on items that are in line with the company strategy, combined with finding a balance between compliance and competitive edge, within the boundaries of legislation and risk strategy of the bank.

Do you have any role models in the industry who have helped or inspired you?

I wouldn't call them role models but Frank Vogel and Bastian Cohen are the ones who gave me the freedom and opportunity to develop myself into what I am today.

I am thankful for all the trust and opportunities that they have given me to improve my skills and gain the knowledge and expertise that I now have.

Now that I have left ABN AMRO and when I look back, I realise that I learned a lot of different things from a lot different people.

Like the TV series Everybody Loves Raymond, you seem pretty popular. What's the key to your success?

Thank you but I don't think everybody agrees with you! Through the years I have gained a lot of knowledge, experience and created a strong network in the grey area between business and IT, and I have a proven track record of delivery. I am WYSIWYG (what you see is what you get) and therefore not so complex to read or work with.

What are your ambitions?

Sander Baauw and I began working at Synechron on 1 May 2012. We are responsible for leading and expanding the European operations and the securities financing practice worldwide. With our knowledge, experience and network, combined with the proven excellent IT execution power of Synechron, we want to help as many participants in the securities finance industry with our IT solutions and make this new adventure a big success.

I see a lot of banks that are doing the business for years with the same systems and processes. The ambition is to help these banks break through their existing way of thinking and implement solutions that increase their efficiency and/or lower their total cost of ownership. We want to create a solid foundation that is flexible enough to adapt to any new situation or opportunity in the future.

What about regrets? If you could go back in time, what would you change or do differently in your career?

My mother is from Indonesia and is a fantastic cook. My sister was a professional cook for many years in several nice restaurants in Amsterdam. Running an Indonesian restaurant with them is something that we have talked about many times, but for several reasons this project was one of the few that was not implemented.

What are your hobbies and interests?

I play tennis and golf, and I have to pick up on my running again in 2013 (after too much drinking and eating during the Christmas holidays). I love my work and it involves a lot of traveling, but when I am at home I enjoy quality time with my family and friends. SLT

Raymond Vuyst
Managing director for continental Europe business
Synechron

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