SLT SECURITIESLENDINGTIMES

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A match made to strengthen

NEW YORK 21.01.2013

Albert Fried & Company is expanding securities lending into a newly created prime lending services division.

The firm currently provides prime brokerage and clearing, execution, trading services and trading technology, and commission management and top-level research.

It is marrying securities lending and prime services so that it can provide them to hedge funds, traders and other buy-side clients.

In a statement, Anthony Katsingris, COO of Albert Fried & Company, said: "[Our firm's] prime lending services division will provide clients with direct securities lending market access as well as customised prime brokerage services. Clients will benefit with a unique transparent view of the securities lending market."

Albert Fried, the firm's CEO, added that the new division will provide clients with direct securities lending market access as well as customised prime brokerage services. "Clients will benefit with a unique transparent view of the securities lending market," he said.

Albert Fried & Company has hired Vincent Avena and Paul Stegmann as managing directors of the new division.

Avena was previously managing director of securities lending at BNP Paribas, while Stegmann joins Albert Fried & Company from Credit Agricole, where he did the same job.

The pair will work with Gerard Losurdo, the firm's current managing director of securities lending.

"Many firms need securities lending representation but do not want the cost of building and maintaining a full-time securities lending operation," explained Losurdo. "[Our firm's] prime lending services [division] will provide clients with a customised, top-notch securities lending department when and where it's needed. In addition to providing transparency, this new standalone securities lending facility will provide clients with complete anonymity for borrowing or lending in the securities lending market."

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RMA positive about FSB's 'shadow banking' recommendations

The Committee on Securities Lending of the Risk Management Association (RMA) has responded to the Financial Stability Board (FSB) on its proposals to toughen up regulation of 'shadow banking', praising the board's efforts to understand the sector.

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Three's the magic number for Citi, Euroclear and Clearstream

Citi is launching a triparty collateral management solution in conjunction with triparty agents Euroclear Bank and Clearstream that will allow mutual clients to consolidate their equity and fixed income holdings into a single collateral pool.

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A match made to strengthen

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Katsingris said: "We're delighted to partner with Avena and Stegmann to expand our existing infrastructure. We continue to make a deliberate effort to recruit exceptional individuals with deep product and market knowledge to our team. The addition of their collective talents and relationships will prove invaluable in building and executing on our longer term goals in prime services."

Avena said that "securities lending will drive the prime brokerage business rather than the prime brokerage driving securities lending" in the new division.

Stegmann added: "This is a great opportunity to bring securities lending expertise and transparency to market users who have been underserved in this area. In addition to our core strength in domestic and international lending, the division will offer clients the added benefit of access to alternative financing. This will be particularly important once Dodd-Frank [the US act] and Volcker rules fully take effect."

RMA positive about FSB's 'shadow banking' recommendations

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In its continued efforts to strengthen oversight, the FSB asked for feedback in November 2012 on its 13 recommendations, including mitigating the spill-over effect between the regular banking system and the shadow banking system, reducing the susceptibility of money market funds (MMFs) to 'runs', and dampening risks and pro-cyclical incentives that are associated with secured financing contracts such as repos and securities lending that may exacerbate funding strains in times of runs.

The committee for the RMA replied with a 40-page letter on behalf of several of its members, including BNY Mellon, BlackRock, Citigroup, Northern Trust, State Street and others.

While praising the FSB for its "thorough analysis" of the market, the committee reminded it that securities lending is subject to significant regulation in the US and Europe already, with legislation such as the Dodd-Frank Act, Basel III and UCITS, and suggested that the board integrate its recommendations with these, rather than "recommend changes that would impose additional burdens on agency securities lending activities".

Looking at systemic risk, the committee suggested that it would be better achieved through position- or exposure-based reporting directly to regulators on a periodic basis, rather than via transaction reporting to a trade repository.

On the topics of both corporate disclosure requirements and reporting by fund managers to end-investors, the committee was even less keen, pointing out that enhanced disclosure should not require disclosure of information that would not be considered sufficiently "material" to be disclosed under current standards; that it may in fact be harmful or create market confusion; and that if taken up, it should be subject to cost-benefit analysis.

However, the committee supported the FSB's recommendation that there be a carve-out for cash collateralised transactions that are demand-driven, but noted that it would be inappropriate to require minimum haircuts for agency securities lending and reverse repo transactions, "regardless of whether they are collateralised by cash".

"Therefore, the RMA urges the FSB to expand the carve-out to also include any demand-driven securities lending or reverse repo transaction collateralised by liquid assets."

The committee stated that it looked forward to further dialogue with the FSB, saying: "We submit that only through such a holistic approach can the FSB to make recommendations that will enhance the overall stability of our financial system, while still preserving the important economic and liquidity benefits that agency securities lending activities provide."

Three's the magic number for Citi, Euroclear and Clearstream

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As custodian, Citi will continue to hold the assets of mutual clients, but triparty agents will be able to manage collateralisation directly from client trading accounts.

Using Euroclear Bank's global 'Collateral Highway', clients will be able to use the assets that are deposited with both entities as collateral in real time, maximising flexibility and optimisation.

The alliance will boost the pool of potential collateral that can be used to cover exposures rising from transactions such as repos, loans, derivatives, central counterparty margins and central bank liquidity.

Clearstream's Liquidity Hub Services will enable Citi clients to consolidate their collateral holdings for use within the Global Liquidity Hub to gain coverage of their global exposures from a single optimised collateral pool.

The liquidity hub allows clients to retain their asset portfolios within Citi's custody network while Clearstream carries out collateral management functions including automated optimisation and substitution.

Sanjiv Sawhney, EMEA head of securities and fund services at Citi, said: "Against the backdrop of increased risks related to counterparty exposure and the impending global collateral squeeze, this new offering further demonstrates Citi's commitment to developing open architecture solutions which allow our clients to more efficiently access liquidity pools."

"This service improves collateral optimisation across all asset classes and markets by leveraging the breadth of Citi's direct custody and clearing network that spans over 60 markets. We look forward to working with our partners and expanding this solution."

Frederic Hannequart, chairman of Euroclear Bank, added: "The joint initiative is a significant market development, with the aim of delivering meaningful client benefits at a time when collateral is in greater demand than ever."

"Together, Citi and Euroclear Bank will help our clients better manage counterparty exposures, ease access to liquidity and make more effec-

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tive use of their assets as collateral, while alleviating the challenges of collateral fragmentation."

Jeffrey Tessler, CEO of Clearstream, said: "I am delighted to have Citi as a partner for the further extension of Clearstream's comprehensive liquidity pool. Liquidity Hub Connect will enable Citi to offer its customers the unique advantages of our collateral management services, which are widely acknowledged as the best in the industry and which continue to develop."

Risky business for LCH.Clearnet-cleared bonds and repos

LCH.Clearnet has implemented formal loss allocation arrangements as a means of mitigating systemic risk for bonds and repos that are cleared through its RepoClear service.

The loss allocation arrangements were designed in collaboration with fixed income market participants.

In the event of a RepoClear member default, where exceptional losses are incurred in excess of the financial resources available, loss allocation ensures the ongoing operation of other LCH.Clearnet clearing services by introducing a further level of protection to the default waterfall.

John Burke, head of LCH.Clearnet's fixed income business, said: "The changes we have made to the RepoClear default waterfall highlight our commitment to providing world-class risk management solutions to the markets that we clear."

"Our clearing members overwhelmingly supported this development, with 98 percent of voting clearing members in favour of the scheme. This confirms the importance of our RepoClear service's resilience and highlights LCH.Clearnet's position as the industry-leader for risk and default management methodologies."

The loss allocation arrangements follow changes introduced in August 2012 to separate the RepoClear default fund in London from LCH.Clearnet's cross-asset class mutualised default fund.

Clearstream and 360T launch triparty repo solution

Clearstream and 360T Trading Networks have released a new triparty repo solution through 360T's front office facilities and Clearstream's Global Liquidity Hub. The service is expected to go live in Q1 2013.

The new service integrates Clearstream's collateral management solutions with the trading functionalities of 360T, facilitating corporate clients, hedge funds and asset managers.

The partnership is the latest addition to Liquidity Hub Collect, which is a part of Clearstream's Global Liquidity Hub, enabling clients to raise liquidity and maximise the use of their collateral.

Stefan Lepp, CEO of the Clearstream Banking, explained that the collaboration has made the Global Liquidity Hub ever more attractive to buy-side customers looking for efficient, transparent and reliable triparty repo solutions.

"We are delighted to be working with 360T which has tremendous expertise in offering services to corporates and we are convinced that together we can add significant value for our mutual customers."

Carlo Kölzer, CEO at 360T, said: "With the seamless integration of the 360T trading platform and the Global Liquidity Hub, we will enable our clients to benefit from a single trading venue for electronic trading. Moreover the whole product life cycle from price discovery to execution and settlement will be faster, more reliable and fully STP-supported."

Basel treads water until 2019

After a Switzerland summit that saw bankers heatedly lobbying for more relaxed reforms,

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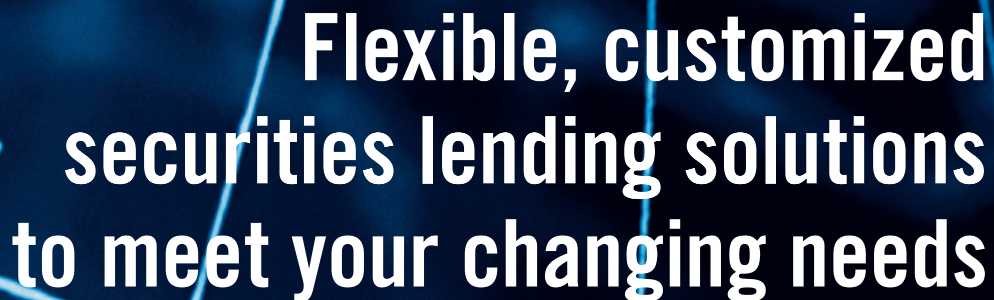

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banks now have until 2019 to achieve a liquidity coverage ratio (LCR).

The Basel Committee on Banking Supervision also said that more assets would now be considered liquid, such as corporate bonds and some shares

New rules will still come into play on 1 January 2015, with the proviso that lenders will only need to prove that they hold 60 percent of the required ratio

In a statement, Nigel Willis, partner at Deloitte, said: "The implementation of the LCR is an important step towards the creation of a global framework for bank liquidity. These initial minimum standards should be further enhanced when negotiations regarding the net stable funding ratio are concluded."

"The combination of a phased implementation timetable for the LCR, broader definition of what constitutes a liquid asset and confirmation that a bank's stock of liquid assets can be used in times of stress, strikes a welcome balance between the competing demands of raising regulatory standards to increase confidence in the global financial system, and not impeding the recovery of the global economy."

eSecLending scrubs up nicely for Dow Chemical

The Dow Chemical Company has chosen eSecLending to act as securities lending agent for its US pension plan assets.

Gary McGuire, chief investment officer of Dow Chemical, said that the firm's consultative approach was a key advantage, as well as an "ability to customise our securities lending programme to incorporate Dow's specific risk/return profile".

"As we re-engage in securities lending for the first time in several years, we are pleased to be partnering with an institution whose interests are aligned with ours."

eSecLending's co-CEO, Karen O'Connor, said: "We are thrilled to establish a relationship with Dow Chemical and further expand the breadth and depth of our pension client base."

ASIC protects Australian money market funds

The Australian Securities and Investments Commission (ASIC) has said that idosyncracies in Australian money market funds mean that concerns expressed by international organisations such as IOSCO over their regulation does not apply to Australia.

"We found that money market funds in Australia do not share many of the characteristics that are prevalent in US and Europe and have little impact on the short-term funding market in Australia," said ASIC commissioner Greg Tanzer.

"For example, the susceptibility of money market funds to runs, or investors wanting to exit the fund simultaneously, appears low in Australia because of the absence of any significant mismatch between liquidity and redemption terms, the use of marked to market valuations and the existing ability of fund managers to freeze redemptions in turbulent times."

The role of money market funds in the Australian short-term funding market is significantly smaller compared to overseas markets. Estimates put the short-term funding market to be around $250.6 billion. It is estimated that money market funds represent no more than 9.5 percent of the short-term funding market and currently account for 0.5 percent of financial system assets in Australia.

"Our analysis to date does not support regulatory intervention for money market funds. The

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current regulation and market practice in Australia is aligned with IOSCO recommendations," added Tanzer.

"However, we will liaise with industry to encourage standardisation in product branding to better distinguish funds that are known as 'enhanced' money market funds from other money market funds. We consider it would be preferable if the term 'money market fund' or similar terms such as 'cash', were used only by funds that have a low weighted average life and dollar weighted average maturity."

Clearstream feels dip in securities financing

Clearstream's global securities financing (GSF) services recorded a monthly average outstanding of €555.7 billion in December 2012.

The combined services, which include tri-party repo, securities lending and collateral management, collectively experienced a loss of 13 percent compared to December 2011 (€638.7 billion).

For the year 2012, the monthly average outstanding reached €570.3 billion compared to €592.2 billion in 2011, a decrease of 4 percent.

However, the value of assets under custody held on behalf of customers increased by 3 percent to €11.2 trillion, compared to €10.9 trillion in December 2011.

Securities held under custody in Clearstream's international business remained unchanged at €5.9 trillion in December 2012 compared to December 2011, while domestic German securities held under custody increased by 7 percent from €5 trillion in December 2011 to €5.3 trillion in December 2012.

For 2012, the yearly average of the value of assets under custody held on behalf of customers reached €11.1 trillion, the same as in 2011.

OneChicago year volume tops 6.3 million

Equity finance exchange OneChicago has released its December 2012 figures, showing a 142 percent increase in volume year-on-year.

The month's volume of 1,291,562 was up 168 percent on November. Total volume for the year tops 6.3 million, up 174 percent above prior year levels.

Other December highlights included 1,272,739 exchange futures for physicals (EPFs) blocks traded, with EPFs and blocks activity representing $5.6 billion in notional value.

Open interest stood at 598,887 contracts on the equity finance exchange at the end of December 2012, up 70 percent year-on-year. The month also saw 56 percent of month-end open interest in OCX.NoDivRisk products.

OCC sees securities lending loan increase

OCC securities lending counterparty (CCP) activities saw a 92 percent increase in new loans year-on-year with 86,694 transactions in December 2012.

Annual stock loan activity was also up 31 percent from 2011 with 973,384 new loan transactions in 2012. OCC's stock loan programme ended the year with an average daily loan value of $35,891,601,372.

Futures cleared by OCC reached 4,662,503 contracts in December, a 124 percent increase year-on-year. OCC's annual cleared futures volume reached 38,304,493 contracts in 2012, an increase of 96,738 contracts over 2011.

Exchange-listed options trading reached 312,528,471 contracts in December, a two percent decline year-on-year. Total options volume

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for the year reached 4,003,871,308 contracts, a 12 percent decline over 2011.

Repo flying but trading volume dips at Eurex

The international derivatives markets of Eurex Group ended 2012 with a turnover of approximately 2.3 billion contracts, a dip from the 2.8 billion seen in 2011.

The total volume for 2012 splits into 1.7 billion contracts traded at Eurex Exchange, a drop from 2 billion in 2011, and 631.8 million contracts traded at the International Securities Exchange (ISE), a drop from 778.1 million in 2011.

At Eurex Exchange, the equity index derivatives segment was the largest in 2012 with a total yearly volume of 765.6 million contracts, still a drop from 954.7 million in 2011.

Derivatives on the EURO STOXX 50 index were the largest single product with 315.2 million futures and 280.6 million options. The equity derivatives segment (options and single stock futures) saw 411.0 million contracts (2011:449.6 million).

Eurex Repo, which operates CHF Repo, Euro Repo and GC Pooling markets, reached an average outstanding volume of €234.7 billion across all repo markets in 2012, compared to €276.6 billion in 2011.

The secured money market GC Pooling hit a new record with an average outstanding volume of €145.4 billion, an increase of 23 percent year-on-year, and the Euro Repo market totaled at the new peak of €36.1 billion, an increase of 19 percent.

In December 2012, the combined volume reached €227.1 billion, the GC Pooling market reached €151.5 billion (an increase of 8 percent year-on-year), and the Euro Repo market recorded an average outstanding volume of €39.5 billion, an increase of 15 percent.

Clearstream and Belfius expand collateral services

Clearstream and Belfius have agreed to develop exclusively a new collateral management activity for bilateral trades, focusing on OTC derivatives and aimed primarily at corporates and medium-sized banks.

The deal is the latest strategic partnership that Clearstream has entered in to, as it extends its Global Liquidity Hub, a collateral management environment delivering worldwide services across borders, asset classes, time zones and products on an open architecture basis.

Clearstream will target mid-sized banks and buy-side customers and will offer margin calls, dispute management, portfolio reconciliation, legal contract review and administration, payments and settlements reporting, a cash reinvestment mechanism, and collateral transformation.

Stefan Lepp, head of global securities financing at Clearstream, said that this latest partnership reflects a welcome and important expansion of the Global Liquidity Hub that would deliver not only a new service to banks, but also strengthen Clearstream's offering to the corporate world in line with growing demand in the OTC derivatives space.

"We're delighted to be working in partnership with Belfius and to be expanding our service portfolio both to buy and sell-sides as collateral management is a priority right across our industry," he said.

"With this unique service, we are able to address the growing pressure triggered by regulatory changes in the OTC derivatives world on a short time-to-market basis."

Luc Van Thielen, COO at Belfius Bank, said: "This is the recognition, by a well-regarded market player, that Belfius has robust collateral management processes in place. Especially in the changing context of EMIR (European Maket Infrastructure Regulation), this partnership can be of real added value to the market for players active in the OTC derivative space."

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A lender's perspective: Universities Superannuation Scheme

The UK pension scheme for higher education institutions is no stranger to securities lending. SLT talks to Leandros Kalisperas, who oversees its programme, about the importance of greasing the wheels of an investment machine

MARK DUGDALE REPORTS

How does USS view securities lending?

It's in the context of my role at Universities Superannuation Scheme (USS) looking after the credit portfolio that I was asked to oversee our securities lending platform and policy. It's not a full-time job for anyone here and I guess that speaks to the relative importance of it, as we don't run any sort of optimised treasury model at this stage. Securities lending is a by-product of the investment allocation to the extent that we are long-term holders of securities, and therefore we do that activity within guidelines. We don't currently do fixed, long-term securities lending, such as collateral upgrades or six- or 12-month trades, or anything like that.

When USS first started lending securities, the emphasis was on recouping custodian costs with our agent lender J.P. Morgan, which is also our custodian. We do cover our costs on that, which is good, and then we do make some extra money.

We're long-term holders of equities, for example, so we're happy for other people to borrow our shares and short them if they so wish. We can generate a fee from that. We're also long-term holders of index-linked bonds, so if people need bonds for liquidity purposes or other reasons, then again we're happy to lend those out over short periods and so on.

It is important to say that from a profit perspective, when you look at the scheme overall, securities lending only returns a small handful of basis points. So it really is noise at the overall scheme level. But from an operational perspective, meaning costs and budget, it's a useful line item for covering those things—it's just not a return-optimising operation from an investment standpoint.

How strict are your guidelines around securities lending?

Our guidelines dictate that we only operate an open securities lending programme, so we have to be able to recall securities at any time. It's a safeguarding scheme for custody-held assets and about not letting them out of our hands for any fixed terms. We need to be able to recall securities whenever we want.

We also, as others do, make sure that if we receive collateral (rather than cash) as security, then it's up to our agent lender to make sure that the haircuts and so on that it demands of the borrower are sufficient. If there is a shortfall, then it is for the agent lender to deal with that.

How important is your agent lender to your business?

From our perspective, we couldn't run the complex range of activity that is involved in securities lending without our agent lender. We would have to have an in-house team if we were going to bypass an agent lender and talk to the market directly. This is not something that we have or envision having at this stage, so J.P. Morgan is very important to us in doing the business.

Why is securities lending a bundled service?

At this stage, we have taken the view that this is an incremental return to our business rather than something that is a real driver of anything. We also have a number of moving parts in terms of the derivative and collateral pieces in our investment programme, and J.P. Morgan as our custodian assists on a number of things in a number of those areas. If securities lending were to be stripped out, then that would become an operational burden because it would have to be outsourced to a different provider that would have to plug into J.P. Morgan. We periodically review this but this is our current view.

What else does your agent lender do for you?

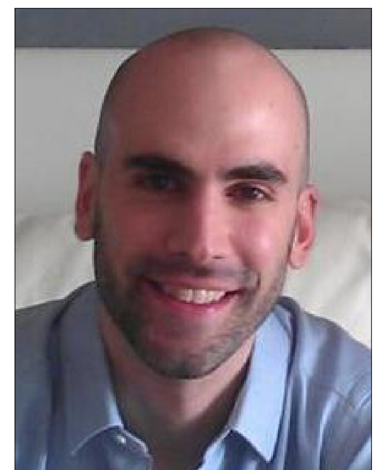
We have periodic performance reporting and reviews of the portfolio. We do set some broad targets for the year with J.P. Morgan running a model for the portfolio, but we discount a lot of that because it's uncertain. There are very few aspects of securities lending that we can treat as guaranteed income.

How difficult to predict is the business?

The market seems to change month by month. As a pension fund, we hold long-dated bonds, for example, and it seems like that at some point last year, people were more interested in the shorter-dated stuff, so we weren't lending out as many of our bonds. But then there was a lot of demand for some of our emerging market / Asian equities. We had lots of stock out on loan there. We don't try to think too hard about that. We try to negotiate a decent fee split for ourselves vis-à-vis the agent lender and monitor the programme through the year to see how it's doing.

What is on the horizon that you need to be aware of?

Something that people are talking about is the move towards central clearing and the need for high quality collateral. The demand for certain securities may increase in certain pockets, but our own requirement for that collateral to be used elsewhere may also increase. **SLT**



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Universities Superannuation Scheme

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In the mix: PGGM on agent lenders

Agent lenders and beneficial owners go hand-in-hand, but in which direction are they heading? SLT talks to Roelof van der Struik, who co-heads the securities lending programme at PGGM, about the all-important relationship

MARK DUGDALE REPORTS

What is most important to beneficial owners at the moment?

Risk is king at the moment. That's quite clear. We already had a focus on operational risk and that has increased here tremendously. It's not really trade risk/return trade off that has changed, but the risk of mistakes in the chain of events, and that's where you expect your agent lender to have a very robust process. If that process is made simple, then it can be made more robust.

What is the ideal agent lender?

I have a preference for your custodian being your agent lender, unless there's a good reason for something different. This is for several reasons. Firstly is because securities lending is operational. There's a lot of operational hassle in loans—a lot of movement—so who is better equipped to do it than the custodian? Secondly, if you have a third-party agent lender, you basically have an extra mouth to feed, and you add complexity, because you don't have two parties to deal with, but three. This just makes it more difficult to manage.

Having said that, if you have your custodian as agent lender, then you also add politics into it, because other departments within the organisation will also have an opinion on who should be the custodian. Then, if you like it or not, the price for custodial services is always dependent on the securities lending deal. Of course, they are completely separate, but Citi is our most important agent lender and custodian, and if we were to pull the plug on securities lending with them, then they would most certainly complain. The custodian's earning model will most certainly change if you completely remove securities lending from the mix.

Do agent lenders add value?

The added value of agent lenders as a whole is taking care of operational issues in the sense that they have quite large and robust IT systems to facilitate lending. We don't use EquiLend, but it is a good example of that. If you want to do the full-blown agent lending side yourself, then there is a quite a hefty cost to bear. I think that agent lenders are quite handsomely paid for their services. If you are of a certain size, then you can make a business case quite easily for doing a 'lending light' programme yourself. There is always that competitive element with your agent lender—you could take it in-house if you wanted to, but you'd have to scale down the programme given the operational complexity and cost that makes up securities lending. But with 100 ISINs making up 90 percent of our earnings and a portfolio management system in-house with a lending module, you could say that doing lending ourselves is doable

I'm convinced that an agent, if you select the right one, does add value. A serious trading desk with a serious number of people sitting in London should have an information and knowledge advantage, so they should be able to get better rates in more markets than we do. Having said that, if we were to run a programme in-house and concentrate only on high earners, we could of course make the game interesting. This is as long as we bring down the complexity of securities lending and restrict ourselves to a few borrowers that would be very keen to do business with us. This way, we could limit the amount of damage to the programme by doing it ourselves.

While I think that we are large enough to do securities lending ourselves, I think that the fees that agent lenders are asking for have improved over the years. I think that the business case for taking it in-house 10 years ago was easier to make.

How is your relationship with your agent lender?

The relationship with the agent lenders is very good, but because our agent lender is also our

custodian, I also have a very good relationship with my operations guys, the custody coordinator and so on. Although we say that it's all separate, we do see it as one relationship.

There are multiple benefits to this. First of all, it's easier to sell. It saves a lot of time as well because I don't have to worry about certain risk or compliance issues, because it's rather a large counterparty, so all due diligence and these kinds of things are done on a regular basis. The other big plus is that they can never point to someone else for making a mistake. It all stops with them. This reduces the potential losses from operational issues, and, as I said before, that is a very popular theme at the moment.

Also, being a good client of a counterparty is important because, if you manage the relationship well, size of course does matter. If you make sure that you're important to a counterparty, it does have its advantages.

But we do have several credible alternatives. For our emerging markets, we have our external asset manager, Robeco, as the agent lender. The rationale behind this is that emerging markets are quite strict and there are different time zones, so time to recall can be very difficult. Putting securities lending in the hands of the asset manager reduces operational risk. The asset manager is allowed to use inefficiencies to create some additional performance. By integrated securities lending it adds a way for them to create a plus in the beta. What you want to avoid is people using methods to go to market that are not the most efficient. For example, you could enter a trade via securities lending or a single stock future. You want the asset manager to choose the most appropriate method with the least risks and most profitability. What you want the asset manager to do is to make the risk/reward decision for you, so you can then reward him for the total package.

What's in store for the beneficial owner/agent lender relationship in the future?

If you look towards the future, I think that the added value of the agent lender is rapidly changing over time quite. Ten years, or so, ago, your custodian was the only route to market—the only choice that you had. Then the likes of eSecLending arrived saying that they could add value because they had very good knowledge of the technical side of the business. They are good agent lenders,only I think the custodial agent (stimulated by the competition) has caught up—they've closed the gap. As the differences in technology used by different players becomes smaller, added value comes more and more from commercial skills—having a very good trading desk and having very good added value and keeping complexity down. I have always been a great fan of the Brown Brothers Harriman model; high value, low volumes and really concentrating on extracting the most value out of an ISIN. It's logical because securities lending desk traders are too expensive to be mucking around with few-basis point trades. All low-value trades, if they fit in your lending model, are dealt with by automated trading platforms, leaving the trading desk to concentrate on the specials and new markets. **SLT**

Roelof van der Struik
Investment analyst/manager
PGGM

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No pain, no gain

The creative tension of generating revenue and corporate governance responsibility remains a continuous but not incurable earache, as SLT finds out

GEORGINA LAVERS REPORTS

As fund managers sharpen their corporate governance skills, they are experiencing some cognitive dissonance. Balancing fiduciary responsibility with shareholder activism while engaging in securities lending is a continuous juggling act, which is only becoming more difficult in the hunt for new and higher revenue.

In 2007, the International Corporate Governance Network (ICGN) updated its securities lending best practices at its annual general meeting in Cape Town, South Africa. The ICGN, whose members include some of the world's biggest pension funds, regulators, union representatives and individual shareholder activists, reiterated a code of conduct that was issued in 2005, requesting that companies separate voting record dates from dividend ones and publish meeting agendas well in advance of record dates.

For the first time, it also urged regulators to consider requiring the disclosure of all positions, or significant changes in positions, for blocks of shares for which disclosure would ordinarily be required, even if the position were comprised largely or entirely of borrowed or lent shares. The same would apply to derivative contracts based on those shares.

This is not the first time that the securities industry has encouraged governance-related best practices in securities lending, but ICGN was the first among shareholder activists to come together on a set of principles. In 2005, the Bank of England-sponsored securities lending and repo committee teamed up with the UK Financial Services Authority to encourage lenders to consider their corporate governance responsibilities before lending stock over a period of time when an annual or extraordinary general meeting could take place. The group also said that securities should not be borrowed solely for the purpose of exercising voting rights.

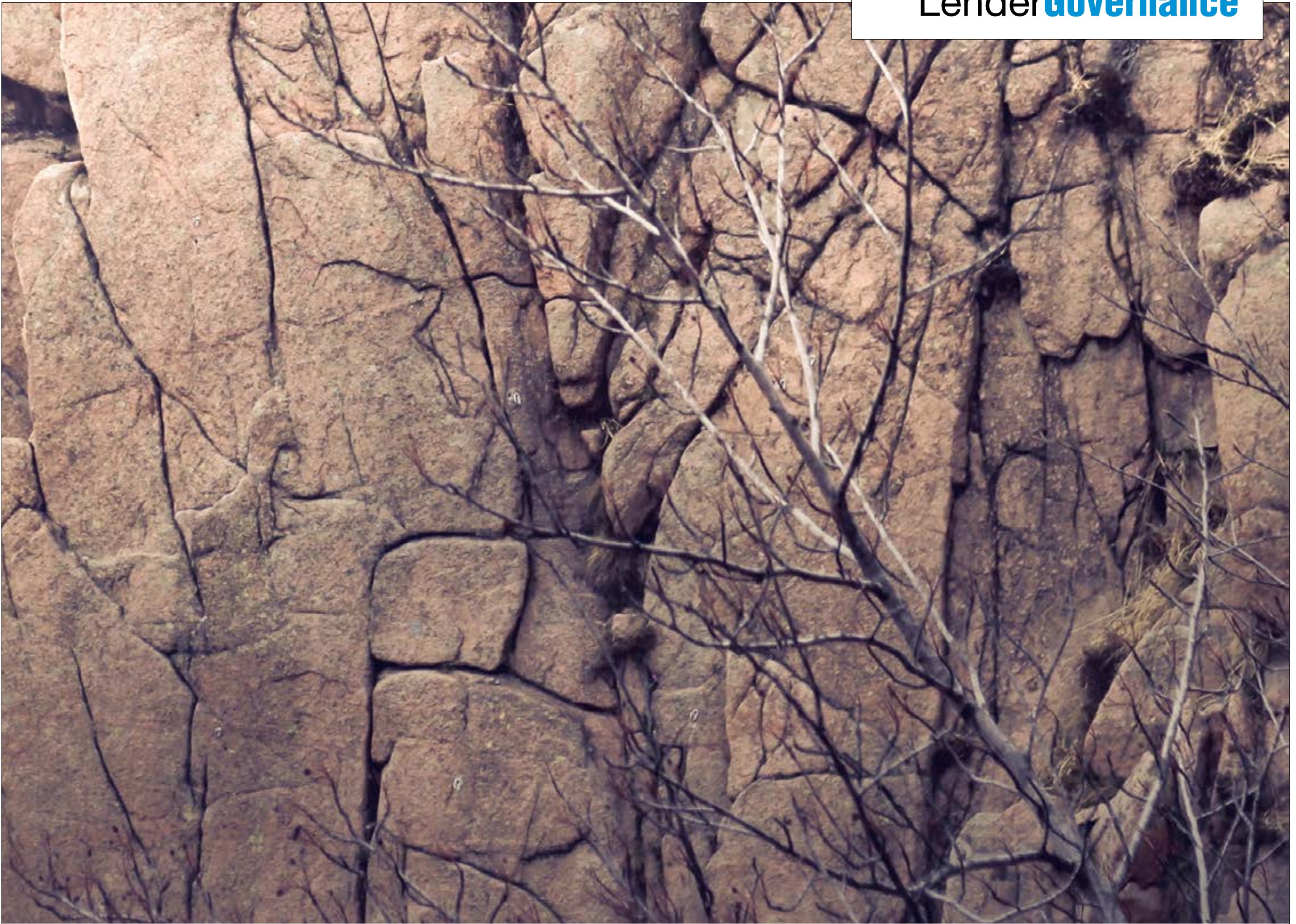
Half a decade on, corporate governance still remains an important topic for many beneficial owners due to increased focus generally on environmental, social and governance (ESG) issues, says Ed Oliver, senior vice president of client relationship management at eSecLending.

"Shareholder activism around items such as pay awards means that the ability to vote is more important today than it has ever been. Regulation is also demanding that beneficial owners have a strong approach to corporate governance. For example, through the 1940 Act, the [US] SEC requires that 'an investment adviser that exercises voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the adviser votes proxies in the best interests of clients, to disclose to clients information about those policies and procedures, and to disclose to clients how they may obtain information on how the adviser has voted their proxies'. The rule and rule amendments are designed to ensure that advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted. All lenders types, not just US mutual funds, should have an established proxy voting policy in place."

"When beneficial owners lend securities through a securities lending programme, beneficial owners will maintain all the economic benefits of those securities as if they were not lent out," comments Sunil Daswani, international head of client relations for securities lending at Northern Trust.

"This is achieved typically by borrowers manufacturing back such entitlements to beneficial owners. The only aspect which is difficult in terms of a client passing onto a borrower—given the transfer of title that takes place when securities are lent—is the right to vote. Therefore many beneficial owners who lend securities forego the rights to vote."

As corporate governance becomes increasingly more important to beneficial owners, in certain securities or markets they will likely recall such 'contentious' securities—per their internal envi-



ronmental, social or governance risk policy—to ensure appropriate voting takes place on such securities, says Daswani.

"We appreciate that clients are well-versed with the relationship between securities lending and corporate governance in terms of managing a programme and ensuring appropriate corporate governance practices are followed. Northern Trust, as a lending agent, is experienced in ensuring its clients are able to vote their stock whilst participating in the securities lending programme."

Taking all of this into account, beneficial owners must carefully weigh the desire to earn revenue from securities lending against their voting rights in lent stocks. This is something that is, historically, somewhat of a challenge.

"While the beneficial owner can recall shares at any time, the decision has been rather binary, ie, 'we will always recall or we won't'," says Oliver. "Now beneficial owners can make more intelligent decisions around the contentiousness of the vote versus the revenue give up (or opportunity cost) of recalling the shares from the securities lending programme. We teamed up with Institutional Shareholder Services (ISS) to launch ProxyValue in 2012 to help beneficial owners with these decisions to balance proxy voting with incremental returns from securities lending."

Daswani adds that voting rights vary according to beneficial owners' policies set within their organisations. "Depending on what beneficial owners do, there are a variety of such options that will have a corresponding impact on securities lending revenue. Solutions include restricting all equities in particular markets from lending (eg, the domestic markets where particularly most reputational risk may arise by large and typically government type entities lending their domestic securities where they are large shareholders); restricting specific (eg, contentious) equities from lending altogether—known as a 'hot list', which is updated regularly; and setting a maximum 'budget' in say US dollar terms of foregoing securities lending revenue for voting (a 'value to vote' threshold) per annum."

Northern Trust clients, says Daswani, tend to combine more than one of these approaches to ensure suitable restrictions are in place. "Of course, on a case-by-case basis, if clients would want to vote on a stock that falls outside their set parameters with lending agents, Northern Trust will reallocate or recall securities from borrowers prior to record date to achieve this, on the basis of timely client instructions."

The idea of a typical set of internal corporate governance rules for securities lending does not exist, agrees Oliver. "We have seen some beneficial owners take an active role in their 'home' market, to the degree that they may recall all securities to vote in meetings in their home country. This tends to be regardless of any revenue discussion. Other clients have a changing list of companies that they restrict from lending during meetings so that they can vote. Generally, when a client has a proactive corporate governance policy this tends to be regardless of securities lending revenue, ie, corporate governance takes priority."

The end goal of achieving best practice corporate governance should incorporate three things, concludes Oliver. "A comprehensive policy that clearly defines parameters for when a vote should be cast or when it is not necessary and therefore securities lending revenue can be retained; reliable information regarding meeting details that allows beneficial owners to ascertain if they should vote or not; and economic data regarding potential securities lending earnings. Many meetings occur at the same time as dividend payments are made so, economically, this can be the best time to have shares on loan for some beneficial owners—a policy with clear parameters and data that meets the criteria is key to success." SLT

All aboard the bandwagon

Could Brazil's CCP-designed lending market foreshadow how the industry conducts business across the globe? SLT takes a look

GEORGINA LAVERS REPORTS

Brazil's securities lending industry has a slightly peculiar make up, at least in the eyes of European or American citizens. The Brazilian Clearing and Depository Company (CBLC), the central counterparty (CCP) of stock exchange BM&FBovespa, accepts collateral from the borrower and holds it centrally.

"The central counterparty design of the Brazilian lending market does pose a challenge for some—the exchange retains control of the collateral posted by borrowers which can unnerve some lenders," says David Lewis, senior vice president at Astec Analytics, SunGard's capital markets business.

"In more European style markets, such collateral is controlled by the lender or more commonly their agent. This allows quick access to the collateral in the event of a borrower default. In Brazil, some fear that not controlling the collateral directly adds risk; however, it could be said this risk is no greater than any other investment/long position in this market, which is also held and controlled by the Brazilian exchange. This 'quirk' does potentially squeeze supply; some funds do not like the perceived risk whilst others (such as ERISA and Mutual Funds in the US) are restricted by regulations over collateral control. On the positive side, restricted supply means that those lending in this market can enjoy higher rewards in return."

"The Brazil lending market is generally a 'specials market', where the average fee is over 100 basis points. As such, the need for bilateral control of collateral for reinvestment purposes to achieve alpha is not as economically important in this market," adds Gregory Wagner, managing director and global head of prime services at Itaú BBA.

"It is a question as to whether market participants are comfortable or legally capable of dealing in a mature CCP venue that does not provide for possession and control of collateral and where they cannot control the type of collateral that the CCP holds on their behalf."

"The eligible assets allowed include Brazil currency are pretty broad—Brazil government bonds, gold, ETFs (exchange-trade funds), LOCs (letters of credit), securities traded in the international markets for non-resident investors, and so on—but the international market needs to look at the CBLC/CCP structure in a more holistic way.

When one looks at the eligible collateral allowed by the CBLC and then compares it to the position limits, the settlement fund and the margin calculation structure that the CBLC uses (CM-TIMS system), the risk profile is reduced: the CBLC uses a volatility based margining structure that requires a minimum of about 115 percent in collateral on easy names and can go as high as 180 percent (in today's market) for more volatile stocks. By comparison, the international markets charge 102 to 105 percent in collateral for 'purpose' lending. Also, generally, there are no margining distinctions between liquid and illiquid names in the international market between counterparties (HF margining will be more dynamic than broker to broker margining)."

The CCP has two distinct disadvantages. In the event of Brazil defaulting, collateral that is held in the CBLC is put at risk, and it puts off global custodians that are accustomed to managing their own collateral pools in finance centres such New York or London from doing business in the country. Even though Brazil has the largest equity market capitalisation, global custodians such as State Street do not offer securities lending services to local investors there.

But in conferences worldwide, regulators endlessly promote the use of CCP-type risk models that seem to emulate the CBLC—despite accusations of it failing to encourage foreign participation.

Representatives of the BM&F Bovespa have done an excellent job in educating foreign participants on the policies and procedures of Brazil securities lending, argues Wagner.

"The exchange has been criticised in the past for not opening up to foreign participants, but there is no way that can be said now. They have been extremely proactive in reaching out to the wider market as of late."

"As recently as last December, representatives from the exchange went on a road show in Europe to educate and encourage foreign custodial banks (which represent pension funds and the like) and other institutions to work toward distributing their Brazil equity assets through the CBLC."

"The BM&F Bovespa representatives are implementing a follow up/action plan to the meetings to further address the questions raised during their road show. It's clear that the local exchange is serious about bridging the gap between home market policies and foreign participation in securities lending."

Their efforts have paid off, with foreign investors representing the largest part of the equities lending pool at 36 percent of the total wallet, says Wagner. "For the borrowing pool, they represent

the second largest share of the of the wallet at 19 percent of market share. Since there are more Brazil assets sitting idly at US and European custodial banks than all of the loans outstanding in the CBLC, it is conceivable that the foreign investor category will continue to increase its market presence in Brazil securities lending."

Despite this, Wagner predicts that the future for domestic participation is still sunny. "For example, the current structure is setup to ensure some domestic participation—a local broker is required to access the settlement system (BTC) to facilitate local and foreign investor trades. This is not dissimilar to how US registered broker-dealers are used to access US markets. So while the foreign participants will continue grow its share, the domestic providers will always have a place in the market."

Lewis adds that his gut feeling is that domestic players will always have a place in their own markets. "They have the connections and experience that the foreign investors and market players will, at the very least, want to align themselves with in the longer term."

"Whilst many international banks and custodians are active in Brazil, they cannot cater for every style of investor and there will always be a demand for domestic participants from certain areas of the market."

The tax system is another suspected downside to the system, and is often accused of driving up securities lending costs for international players.

Lewis says: "The tax system in Brazil is a little complicated, particularly for those participants domiciled outside the country. However, the income levels are relatively high and as such, tax simply becomes a cost of doing the business that has to be met."

"Like the taxes, structural differences in the Brazilian lending market also add friction compared to the more mature European countries, however, securities lenders looking for developing markets with good yields will overcome these difficulties."

The slashing of the Selic

Local asset managers (hedge funds and mutual funds, not including pension funds) represent the biggest borrowers of Brazil assets by a large margin, with close to 70 percent of securities being borrowed for these funds. "Conversely, the funds represent a significant part of the lending pool as well," adds Wagner.

Wagner says that multi-strategy or 'multimercado' funds dominate. They represent almost 50 percent of all strategies.

"These funds employ multi asset investment vehicles—which almost always involved a much more healthy dose of fixed income assets and a smaller portion dedicated to equities and generally long/short bias. This strategy—along with the high Selic benchmark rate—allowed for investors to achieve high fixed income investment yield with little volatility."

Now the Selic has been cut by about 500 basis points—with Brazil's Central Bank Monetary Policy Committee (Copom) cutting its overnight rate by another 25 basis points to 7.25 percent and hinting strongly that its easing cycle has now ended—things have changed for the multimercado funds.

"Multimercado funds are now required to find alternative ways to achieve returns," says Wagner. "This includes increasing leverage (ie, trading in options markets) and tapping into the local and global equity markets. Appetite for risk in these funds must increase to achieve the same benchmark returns previously earned in a higher interest rate environment."

And tapping into equity markets is what these funds have done, with securities lending in Brazil confined to equities despite local investors' preference for fixed-income instruments.

"High local interest rates and strong demand makes borrowing Brazilian fixed income securities extremely expensive, driving investors towards a burgeoning synthetic fixed income market instead," says Lewis.

"Fixed income securities finance transactions are generally governed under repo arrangements," adds Wagner. "Repo arrangements are monitored by the Brazil Monetary Council (CMN). There are a number of rules that apply to trading fixed income repo in Brazil, but for financial institutions it does not require clearing through a CCP (as it does for equities)."

But securities lending is not completely confined to equities. Wagner says: "There is another lending platform called SISBEX but it is significantly smaller than the equities lending platform (BTC)."

In January of 2012, mining company Vale and oil business Petrobras were dominating, together making up almost 20 percent of the market. Minerals and oil firms, along with banking, are the biggest securities, reflecting their positions within the investment markets. Currently, the top equities assets on loan in order of value are Ambev (brewing company), Vale, Bradesco (banking) and BRF Foods.

"Borrowers, in the form of both local and international hedge funds, tend to concentrate on the larger more liquid securities especially those that trade as ADRs (American depository receipts) in the US," states Lewis. "As such, both Vale and Petrobras are popular securities to borrow, but as more investors become active lenders then I would expect interest levels to widen to other less liquid securities."

It seems as though the current Brazilian securities lending model could be the precedent for regulators to stir up lending transactions across the globe. This is a world in which there are no bilateral trades, cash collateral reinvestments are not allowed, fees are transparent, and authorised investment funds are permitted to act as both lenders and borrowers. But criticism over tax and the level of control that is wielded by the CCP means that it could be a while before the model takes hold elsewhere. **SLT**

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The PASLA/RMA Steering Committee have put together a business program important to our industry and the region. The conference will kick off Tuesday, 6 March with the Securities Lending Tutorial followed by a round table discussion on Current Operations and Technology Trends in the region led by members of the PASLA Operations and Technology Subcommittee and leading technology vendors. We are also pleased to have Dr. Kalok Chan, Department Head and Synergis-Geoffrey Yeh Professor of Finance, Hong Kong University of Science and Technology lead an academic discussion on his coauthored paper, Short-sale Constraints and A-H Share Premiums.

Other sessions include:

- Regional Collateral Management and Repo Update
- The Future of Securities Finance in the Asia/Pacific Region
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- Legal and Regulatory Issues, including a two-part round-table discussion where representative counsel and senior business leaders will discuss the implications to our industry and how to react.

Registration and Sponsorship details are available on RMA's website at www.rmahq.org/pasla.

A year of two halves

Last year was encouraging for securities lending, but North American market participants held off on any great activity to wait for legislation. SLT's experts discuss the issues

Mark Payson
Global head of trading and asset liability management
Brown Brothers Harriman

Paul Wilson
Managing director
J.P. Morgan Investor Services

George Trapp
Senior vice president and head of securities lending client relations
Northern Trust

Joe Pellegrini
Vice president, business development
OCC

Christopher Holzwarth
Head of global sales, relationship management and consultant relations for securities finance
State Street Corporation

Mark Dugdale
Editor
Securities Lending Times

J.P.Morgan

Northern Trust

State Street.

How was the end of 2012 for your securities lending business?

Mark Payson: From a revenue standpoint, 2012 was stronger for lenders than 2010 or the year after. Returns didn't reach the peak we saw in 2008, but it was an encouraging year for the industry, and certainly for beneficial owners. We saw hedge funds show a bit more conviction and add leverage in certain areas, which boosted demand. We saw returns rebound in key developed lending markets such as the US and Hong Kong due to demand for specific sectors. And compared to the prior two years, returns on seasonal structured trades in developed European markets increased on the back of better corporate earnings in certain segments.

As we see near any year-end, towards the close of 2012, activity and volumes slowed a bit—hedge funds and other borrowers usually don't want to risk a drop in performance late in the year, and instead choose to lock in their year-to-date returns, good or bad. This year, US market participants were also watching the evolving regulatory landscape and waiting for more clarity, leading to a pause in new activity. This wasn't really a year-end phenomenon, but something that the industry has been battling for a while. Speaking for BBH, we saw a lot of new client engagement during 2012 and a good portion of this was in Q4 when we saw more new business converting and more organic growth as beneficial owners committed to more robust reviews of their lending programmes.

Paul Wilson: Overall, 2012 was positive, but it was a year of two halves. The first half of the year was very strong, the second half of the year less so and that became quite challenging right at the very end of the year, given many of the macro-economic factors impacting markets and consequently subduing demand. From our own perspective, throughout the year we added more clients across all regions, we expanded into new markets and expanded the breadth of collateral, given the importance of collateral flexibility. We deepened the consultative approach with our clients and found many very willing to review their lending parameters and consider additional ways within their overall risk framework to add additional return. Overall, in contrast to the market challenges already noted, we found our clients had a positive appetite for additional return. It would also be fair to say that the year-end was very busy with reviewing and responding to a variety of regulatory papers on securities lending and repo.

Christopher Holzwarth: This was a difficult year, given global macro-economic instability, regulatory reforms, eurozone market volatility and a flattening yield curve that defined market conditions. Regardless, State Street's securities lending programme performed well and saw an unprecedented number of new business wins, particularly in Q4.

As is typical of Q4 activity, investor volumes contracted at year-end from market deleveraging. However, there was less demand than usual, due to a number of unresolved political and budgetary issues. These include the US fiscal cliff and LIBOR narrowing its spread to the fed-

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STATE STREET.

eral funds rate, slightly reducing cash collateral reinvestment spreads.

Overall, State Street's 2012 securities lending business was a stable source of funding for our counterparties and provided strong risk-adjusted returns for our clients.

Joe Pellegrini: Two thousand and twelve ended on a good note for the OCC stock loan programme, which includes OCC's internal 'Hedge' programme and the AQS securities lending marketplace. The Hedge programme provides clearing for OTC bilaterally negotiated deals while AQS transactions come to us from the AQS marketplace, matching anonymous bids/offers through its secure, anonymous trading platform. New loan activity in Q4 was up 44 percent over the Q4 2011, and new loan activity in 2012 grew 31 percent over 2011.

Interest from broker-dealers continues to rise as they look to incorporate central counterparty (CCP) clearance to a variety of their OTC products. Several new and existing clearing members have joined the programme in the last year, and we continue to receive a considerable amount of queries from the industry.

George Trapp: Despite the continued global uncertainty and ongoing market volatility, securities lending performance for 2012 improved over the prior year. Larger spreads in some markets and asset classes along with better than expected cash collateral reinvestment yields contributed to an increase in programme revenue for most clients based on their risk-reward profile. Most asset classes experienced a higher gross basis point return as lower loan volumes from subdued demand were more than offset by the larger spreads on the most in-demand (specials) securities. At the end of the year, demand continued to be steady which will hopefully bode well for 2013.

How has the US securities lending market responded to the news about the 'fiscal cliff'?

Holzwarth: The securities lending market generally benefits from a healthier and more active capital market environment. The agreement reached for the 'fiscal cliff' restored a sense of stability to the markets, allowing lending participants to continue in their investment strategies. We have already seen increased price action in both the US equities and treasuries spaces. News about the fiscal cliff produced stronger flows for capital markets and, we believe, subsequent stronger flows for the US securities lending market.

Trapp: In addition to the fiscal cliff, there were several macro-economic factors that affected the markets throughout much of the year, including ongoing concerns over the sustainability of growth in the US and China and the lack of clarity regarding the final form of global banking and financial services regulations. Despite all of this uncertainty and market volatility, global equity markets posted solid gains for the year with both the S&P 500 and MSCI World ex US indices up 13 percent.

All of these factors contributed to ongoing investor unease, with many choosing to remain on the sidelines. Hedge funds put less money to

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State Street

work given the uncertainty in the equity markets and many deployed leverage in the fixed income space as an alternative. Throughout the second half of the year, as global equity markets rallied, many hedge funds ramped up leverage on the long side to take advantage of the strength in equity markets while reducing short exposure. These factors contributed to overall softer borrower demand throughout much of the year, with loan balances being generally flat to lower for much of the period. As mentioned before, the spreads on specials however were very strong.

> Holzwarth: Definitive direction on issues such as taxation or regulatory change would remove a degree of uncertainty for clients evaluating risk

Payson: The fiscal cliff itself was really a non-event for the securities lending market. More than anything, it just added to the noise caused by the regulatory ambiguity and macro-economic concerns that have been affecting the demand side of our business for the better part of three years. The pending budget discussions are a similar story—right now they are just part of the lingering ambiguity that we are experiencing as a result of the lack of a defined policy, but they aren't affecting anything on their own.

Pellegrini: I can't speak from a trading perspective, but from OCC's perspective we don't see any significant impact. OCC's clearing membership is very comfortable with our risk management practices and securities lending volume is not dictated by credit or counterparty default risk.

Wilson: Generally speaking, a variety of different macro-economic factors negatively affected demand. The concerns over the fiscal cliff have existed, but from purely a securities lending perspective, this has not had any material impact. Clients have not changed their approach or appetite for lending through this time of uncertainty, which continues the trend we have seen since the re-calibration of the industry post the global financial crisis.

To what extent do risk appetites improve in the US when politicians act rather than dither?

Holzwarth: Political uncertainty tends to dampen the risk appetite of market participants. As a result, trading flows are reduced and investors opt out of equity and growth markets.

Definitive direction on issues such as taxation or regulatory change would remove a degree of uncertainty for clients evaluating risk. Clients today are more cautious when structuring their lending programmes, and want to be sure that the overall investing environment is stable and promising. Long-term political indecision can distort their ability to set expectations, increasing the number of lenders reflecting a more risk-averse approach to their programmes.

Wilson: Our experience over the last several years is that clients and lenders have been less pro-cyclical in their approach and appetite for lending. There were a variety of market events in the latter half of 2011 and 2012 has had its moments too. But clients and lenders have stayed very true and consistent in their approach, which just adds to our view that clients and lenders are very comfortable with their lending dynamics. We see plenty of ongoing modifications that form part of the regular assessments that clients and lenders undertake, but the strong bias has been making modifications that allow for the capture of additional return.

Payson: Globally, 'action' is much better than the alternative. Clear policy and actionable rules, even those that could be considered more restrictive to business, are better than the enormous ambiguity plaguing the markets right now. Market practitioners are very smart people and have shown an incredible ability to adapt as change happens. No doubt, financial engineering will occur. The key is to define the new rules and then adaptations will follow. Uncertainty, combined with this waiting game, are two of the largest inhibitors to improvement on the demand side.

How are upcoming regulations affecting appetites for risk?

Wilson: There are plenty of upcoming and impending regulations and as many, if not more, white papers. New European short selling rules, European Securities and Markets Authority (ESMA) guidelines for ETFs and UCITS, various European financial transaction tax regimes, various titles within the US Dodd-Frank Act, most notably Sections 165 and 166, the Financial Stability Board's 'shadow banking' paper on securities lending and repo, and Basel III, are keeping us more than occupied.

When we look at all these regulations, we see a number of themes covering systemic risk and inter-connectivity, transparency, investor protection, collateral, and tax developments. Thus far the prospect of these regulations has not changed client and lender appetite to lend, and as noted, clients and lenders on the whole are seeking additional ways to increase revenues. However, this is the number one watch area for 2013, as many of the regulatory developments will start to crystallise and the effects will be a little clearer.

Holzwarth: Although the Dodd-Frank and Basel III regulatory initiatives remain in the development stage, we anticipate that they could have a significant impact on the lending marketplace. The proposals to limit credit exposure to any single counterparty and to change the calculation of risk-weighted assets may negatively affect the industry. The proposals could also force banks to hold greater capital against securities lending transactions, limiting the volume of trade. However, we believe that client confidence and risk appetite will increase as banks become better capitalised and more stable.

Payson: We have a bit more clarity now, but the continued ambiguity is limiting market participants from investing or putting on trades and taking risk, and rightly so. Absent more clarity, there is just too much downside risk to employing certain strategies in this market. Over the past few years, this has resulted in investments in the alternative space being limited to long positions, cash, and strategies that do not drive equity borrowing. At this point though, the issue has as much to do with the waiting and uncertainty as it does the final rules.

> Payson: Market practitioners have shown the ability to adapt as change happens. No doubt, financial engineering will occur

Pellegrini: Upcoming regulations are definitely forcing institutions to review their collateral

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needs and risk management practices. Firms are looking closely at how they are conducting business and finding ways to address these regulations (upcoming or existing) to ensure OTC transactions are less risky and to provide a better strategic fit for their organisation. This applies to securities lending transactions as well and trading through a CCP may improve the trade's risk profile.

What about the CCP model? Is an electronic business safer than a relationship one?

Pellegrini: At OCC, we have always believed that stock loan transactions cleared through a CCP present a more secure model. The task is for each firm is to decide which transactions benefit from the CCP model based upon collateral obligations and economics of the trade. Not every securities lending transaction may benefit from a CCP model, but I believe many firms can reap some benefits, whether from a capital requirement perspective or as a credit intermediary, for some portion of their portfolio.

From a trading perspective, the AQS platform, for which we provide CCP services, offers a safe, accessible automated market with price transparency and open order book for credit efficiencies.

> Pellegrini: Not every securities lending transaction may benefit from a CCP model, but I believe many firms can reap some benefits

Wilson: As has been widely stated before, CCPs do bring many benefits to differing securities and derivative markets, but we do not feel that that the securities lending industry in its entirety is conducive to a CCP. As noted, clients and lenders have highly bespoke lending programmes, especially relating to counterparties, collateral and haircuts, and these they feel are appropriate for the transactions that they are undertaking. A CCP typically works on a one-size-fits-all-basis and so mandating a move across the industry to centrally clear would cause many clients and lenders to cease lending, and this would be disruptive to markets. That being said, we can see some specific situations and scenarios that the existing benefits of using a CCP (such as lower capital requirements, netting, etc) could create financial and operational motivation for increased consideration.

Holzwarth: There is still uncertainty regarding how CCP models may shape the securities lending industry. In theory, there are a number of benefits that a CCP can bring, including the reduction of counterparty risk exposure, anonymity for market participants and improved liquidity. There could also be benefits for capital allocation due to the fact that bilateral transactions will attract higher charges under Basel III.

At present, we do not believe there is a CCP model that has all of the benefits referenced, while also preventing other complications such as lenders being required to put up margin. Current bilateral systems could be just as electronically advanced as a CCP. And with the industry experiencing minimal losses due to a borrower default, there is a question on whether there are risks or issues that the CCP will solve.

Payson: There are certainly merits to introducing a CCP model for securities lending. While I don't think it makes sense to mandate their use, we see it as another option for beneficial owners, with the primarily model still being traditional bilateral arrangements. It is important to remember that the root cause of industry issues in 2008 won't be specifically addressed through the introduction of CCPs—the default of Lehman Brothers as a counterparty is not what caused issues.

It was actually the aggressive or inappropriate reinvestment of cash collateral that created problems for some industry participants, and CCPs do not solve for this. Regardless, we see the relationships between all counterparts (clients, agents and borrowers) to continue to be very important. Lending is much different than many products currently using CCPs, most notably because loans are not spot trades: they have a duration and a monitoring/maintenance requirement to them. And probably most importantly, beneficial owners are seeking more customisation and programmes that are tailored to their specifications, which means the industry needs to provide more flexibility, not less. Adding a CCP as an option would do this, but replacing the current execution options would not.

What are your predications for 2013?

Trapp: Looking ahead to 2013, there will be a lot of focus on many of the main themes that dominated the securities lending market in 2013: uncertainty due to political, economic and regulatory issues, focus on efficient collateral management, and development in emerging markets.

> Trapp: Factors that contributed to lower intrinsic values in US treasuries will have less of an impact going forward, which could generate some incremental income from this asset class

Asia and Europe remain important regions for potential growth, especially with regard to emerging markets. In the US, the factors that contributed to lower intrinsic values in US treasuries are expected to have less of an impact going forward, which could help to generate some incremental income from this asset class. Specials and intrinsic value continue to be an important theme for clients in 2013.

Pellegrini: Discussion of the benefits of a CCP model will undoubtedly continue through the New Year, but I believe trading volumes in OCC's stock loan programme will continue to grow as the industry and our membership gain more and more comfort with the OCC model and the benefits that it can provide.

Payson: Overall, regulatory and tax clarity around the globe, combined with some stabilisation in Europe and other fragile economies, should lead to a better trading environment for many hedge funds. This will lead to stronger lending revenues, but it's unlikely this will happen until later in the year. Two thousand and thirteen will likely look and feel a lot like 2012—we expect the industry will continue to be somewhat subdued by cyclical issues in

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the short term but to be stronger overall in the longer term.

> Wilson: We will focus on controllable factors such as adding new clients and supply across the 'in demand' areas

There are many factors—some cyclical and some secular—that will affect the lending business in the future. I expect that overall, the combination of these factors will be net positive for the lending business, especially from an intrinsic value perspective, as any decreases due to reduced demand for certain trades will be offset by other more positive changes. The most notable of these is that investment into alternatives is expected to grow significantly over the next three years as both hedge funds and traditional asset managers meet the growing demand for investors.

Since hedge fund investments are the main driver of securities lending demand, we can safely conclude that this trend will lead to a noticeable increase in the demand to borrow assets. Of course, we also need to consider how these assets will ultimately be invested. As mentioned, for the past few years, it has been in long positions, cash, and strategies that do not drive equity borrowing, but we expect this particular trend is cyclical and will change. However, the overall increased investment in alternatives is expected to be a secular change and the most influential secular factor that supports long-term industry growth. It's also not a secret that current monetary policy across the globe has resulted in historically low cash reinvestment returns and general collateral balances. We expect this to continue in the short term, but future regulatory developments could mean a longer-term secular change as well.

Holzwarth: We expect that uncertainty related to regulatory and fiscal changes will continue, creating pockets of market volatility that can benefit the securities lending markets. We also anticipate that low nominal interest rates will prevail in an attempt to stimulate growth and employment. In 2012, the LIBOR rate moved to a historical low, narrowing the gap between it and the federal funds rate. Global macroeconomic conditions will continue to be slow to improve. So we anticipate that most of our clients' revenue will be generated from the intrinsic value of their assets, not from the return generated by reinvesting cash collateral.

Since we don't expect the traditional cash reinvestment market to improve returns for clients, there will be continued emphasis on the evolving non-cash collateral and repo collateral markets. Flexibility with respect to acceptable collateral types can increase returns for clients, without taking on the traditional interest-rate and credit-spread risk.

At State Street, we constantly seek new opportunities to generate an even stronger, risk-adjusted return for our clients. This could mean changes in collateral acceptances, specific or modified styles of lending (opportunistic or specials only, versus non-cash or cash profiles), or lending in new markets.

Wilson: I can't remember coming into a year where there were as many variables which each could have a material impact—positively and negatively—on the year. But when all is said and done, I think that the year as a whole will be fine. We will focus and concentrate on controllable factors, such as adding new clients and supply across the 'in demand' areas, continuing to expand flexibility across collateral, adding new markets and closely managing the risk that is associated with market events, should any arise. The only safe prediction is that the year will be dominated by regulation and we will spend more time and energy on it than ever before. **SLT**

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Scrubbing up nicely

As a third-party securities lending agent, eSecLending offers something different to the traditional agent lenders. SLT speaks to Peter Bassler about its latest mandate win

GEORGINA LAVERS REPORTS

At the beginning of January, The Dow Chemical Company, a producer of chemical, plastic and agricultural products, chose eSecLending to act as securities lending agent for its US pension plan assets.

In a statement, Gary McGuire, chief investment officer of Dow Chemical, said that the firm's consultative approach was a key advantage, as well as an "ability to customise our securities lending programme to incorporate Dow's specific risk/return profile", adding "as we re-engage in securities lending for the first time in several years, we are pleased to be partnering with an institution whose interests are aligned with ours".

> Dow is re-engaging, and others that take an investment-oriented approach to a re-evaluation should also consider participating again

Peter Bassler, managing director of business development at eSecLending, explains why Dow Chemical is returning to the market.

Dow Chemical has a specific risk/return profile—how will eSecLending work to this profile?

Most beneficial owners are looking at the securities lending/intrinsic side of the business to generate returns while taking a conservative approach to the investment of cash collateral. For Dow Chemical, we proposed an approach with additional protections that would accomplish this objective. We are lending to maximise the intrinsic value of portfolios while limiting risk on the cash collateral side of the business.

Dow Chemical is re-engaging in securities lending for the first time in several years—is this indicative of a return to form for the sector?

Dow is re-engaging, and others that take an investment-oriented approach to a re-evaluation should also consider participating again. Oftentimes, funds do not view the business in its component parts (lending and cash reinvestment). Both are separate, unique activities and carry vastly different risk profiles. If funds re-evaluate the risks that they are comfortable with and focus on that part of the business (ie, the loan transaction), there still remains the opportunity for incremental return for a low degree of risk.

Does the nature of the client make you change the nature of your operations? How is servicing a pension fund's needs different to a another client?

In our programme, we run individual programmes for each client, differing from a pooled or comingled approach that is used by our competitors, and allowing us to design around each lender's unique requirements. Traditional programmes are often set up to benefit the banks and borrowers in a securities lending programme. As the only true 'independent' agent, our programmes have no conflicts of interest and our objectives are aligned with those of our clients.

How do you determine a client's optimal route to market?

Route to market is typically determined by the client, market conditions, type and size of individual portfolios, and so on. Clients will either use one or both of our execution strategies (discretionary lending and agency exclusives). These decisions are often made in close consultation with us after an auction process.

How is Basel III influencing your offering, if at all?

eSecLending is not affected by Basel III. The bank-managed lending programmes are affected by this and other regulations such as the US Dodd-Frank Act. Both are likely to require higher capital levels for providing indemnification. The current industry view is that this will make indemnification more costly for banks and that this will lead to lower usage or higher costs for beneficial owners. eSecLending uses independent indemnification that already has a hard cost associated with it. Our structure is advantageous from a diversification perspective as these insurance providers are not correlated to our business and have low correlations to the borrowers in the marketplace, which is not the case with bank indemnities.

How do you exercise good corporate governance?

We operate programmes for our clients in line with their corporate governance policies. Based on operating individual programmes at the client level, we can tailor each programme to any and all corporate governance sensitivities. We are also taking a leadership role in this area. Last year, we launched a product called ProxyValue in partnership with Institutional Shareholder Services (ISS). This product enables lenders to evaluate the economic decision of lending alongside the fiduciary decision that comes with the desire to vote proxies from a corporate governance perspective. This is a unique offering in the marketplace. **SLT**

Peter Bassler
Managing director of business development
eSecLending

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Despite today's high-tech tools, market participants continue to suffer from inefficiencies. We are working to do something about that.

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Now available: CCP service for securities lending

Moving on up

Ronald Landry of CIBC Mellon tells SLT why a changing regulatory framework and sound economic conditions are making Canadian exchange-traded funds ripe for lending

MARK DUGDALE REPORTS

How do ETF markets in the US and Canada differ?

I think that they differ quite measurably. Obviously, one is the size difference between Canada and the US. The US is a $1.4 trillion AUM market space and we're $56.4 billion. Even the number of products offered is worth comparing: 1442 in the US, and 268 here. The number of participants are significantly different too; we have eight here in Canada, and then there are nearly 50 in the US.

How exchange-traded funds (ETFs) operate in the US is a little bit different. One of the things that they have that we don't—and we'd like to get there—is an indicative optimised portfolio value agent (IOPV); their role is really to price and publish the ETF basket, and provide pricing every 15 seconds. If I'm an investor, I can easily use the ETFs ticker followed by .V, see what the indicative price is, and compare it to what the market is showing.

Here in Canada, we don't have a similar operation to the NSCC, which is the clearinghouse for ETFs on behalf of DTC. This can create some operational challenges when it comes to asset delivery; overall the process works generally the same way, but we just don't have a centralised clearinghouse that is specifically for the ETFs.

From a structural perspective, ETFs in the US can have a few different types of structures. They can be registered investment companies or unit trusts, they can be granted trusts, master limited partnerships, exchange-traded notes, and so on. In Canada, we do have exchange-traded notes, but all other ETFs are structured as unit trusts, and so its fairly simplistic from that perspective.

Would there be any scope to diversify?

I don't think the regulators are looking to make the market any different than it is currently. It works well and the regulations mirror those for Canadian mutual funds, which is helpful for investors, as most of our retail mutual funds are usually structured as unit trusts as well. We do have retail mutual funds that can be structured as mutual fund corporations, but those aren't available to be ETFs.

I can't see the regulators changing their minds on the regulatory structure. Our unit trusts are very similar to those in the US in that aspect, but we have a little more flexibility. The reason there are so many variations in the US is that most of them are regulatory, you've got the 1933 act (the first major federal legislation to regulate the offer and sale of securities) and the 1940 act. In Canada, you can be a unit trust ETF, a commodity ETF, an Index ETF or an actively-managed ETF, and you can do that all within a unit trust structure.

Another thing that a lot of people don't realise is that the transparency that is mandated in the US, where they're providing NAV, closing market prices to the ETFs, the basket itself and the components in the basket, isn't a legal requirement in Canada. That doesn't mean that ETF providers in Canada aren't providing that information, it's just not a regulated requirement to do so. Canada does have regula-

tions requiring issuer reporting on a quarterly basis, as well as on a semi-annual basis, but we don't currently have a regulation saying that you must disclose your full portfolio on a daily basis. That's a big difference between Canada and the US.

How important is securities lending to an ETF earning more basis points?

Securities lending is not going to be a material change to an ETF's earnings, but it is a very good source of risk-adjusted returns—a low-risk option that many ETFs are choosing because it can help earn a few additional basis points. You can't really generalise the amount of revenue from lending because it depends on the composition and characteristics of the firm's portfolio as well as the lending programme choices that each fund makes.

Why were ETFs excluded from securities lending in Canada?

They were and they weren't. In 2007, there was legislation to allow qualified unit trusts to be lent, and it basically said in very simplistic terms that a Canadian resident mutual fund trust that is listed on an exchange could be lent.

That was great for Canadian ETFs that were unit trusts, and we'd been lending those types of assets for a number of years. The one thing that came out in the latest change was that it no longer needs to be a Canadian resident unit trust. Any unit trusts, regardless of which country it's from, if it is exchange-traded product and it's a unit trust, it can be lent. So that's some good news.

The problem is that the majority of the US ETFs are not unit trusts, which still effectively excludes them from lending: they are legally lendable, but securities lending transactions are treated like dispositions and acquisitions rather than loans, which can create substantial operational and tax barriers. You have a few products—the triple Qs, the spiders, the diamonds—that are structured as unit trusts, so those can be lent without the same challenges.

CIBC Mellon was recently selected to provide Horizons ETFs with securities lending—why are securities lending services bundled, and what are the advantages of this?

Consolidating custody and securities lending services with one provider can definitely create operational efficiencies for ETFs. Whether it's Horizons or any other ETF sponsor, its an economy of scale, having similar processes, building a relationship with your service provider and just knowing that they have a partner that will help with both solutions and issues—you're dealing with one vendor that can deal with those for you. Of course, the strength of the lending provider is an important consideration, so ETF sponsors considering consolidation must do their due diligence to ensure that their custodian is also a good lending agent.

To what extent do bundled services suit the ETF product?

They suit them very well. Having a more than one service provider probably increases your cost in some ways, and may increase risk, for example, if there's a breakdown in communication with one of the other parties, it could delay a transaction. Clients that bundle securities lending with custody can also realise cost and flexibility advantages over a third-party platform—consider a situation when a security needs to be called back from loan. A client with a third-party lender would need to call the security back, there would have to be a transaction—which adds time and costs—and then it would be back into our custody platform. Bundling lending and custody consolidates the securities on a single system: the client calls its provider and we pull it back into its custody account. In addition to the savings on transactional cost, faster response times can help clients mitigate risks in a fluid market.

Canada is considered to be a safe environment in which to do business—how else is the country looking to open up its ETF market that will maintain this while making it more attractive?

Canada has a very strong financial history, with a banking system that is probably the safest in the whole world. We have very strong regulations when it comes to mutual funds. Here in Canada, ETFs are regulated in the same way as mutual funds: heavy, with a lot of oversight. There's a lot of comfort in ETFs and how they're regulated here, and that should give comfort both to Canadians retail investors and large institutions. As an industry, there are improvements being made—specifically, the Canadian ETF Association (CETFA) has a goal to provide information, education and access to resources on ETF investing in Canada. That is to be the knowledge source for everything ETF in Canada. CETFA has a media and public relations committee, which provides the financial sector and the public with insights and updates on recent developments concerning ETFs; a policy committee, that reviews any changes in legislation that may affect ETFs; and an operations committee (that I vice-chair) that looks at how we can improve overall operational efficiencies and ensure any new regulations will work from operational point of view. **SLT**

Ronald Landry
Executive director, ETF services
CIBC Mellon

ETFs across the pond

Canada

- Barclays iPath
- BlackRock (iShares)
- BMO ETFs
- First Asset ETFs
- Horizons ETFs
- Invesco PowerShares
- RBC ETFs
- Vanguard

US

- AdvisorShares
- ArrowShares
- Barclays iPath
- BlackRock (iShares)
- BNP Paribas
- BNY Mellon
- Charles Schwab
- Citigroup
- Columbia
- Credit Suisse
- Deutsche Bank
- Direxion
- EG Shares
- Elements
- ETF Securities
- Exchange Traded Concepts
- FactorShares
- Fidelity
- First Trust
- FlexShares
- Global X
- Goldman Sachs
- GreenHaven
- Guggenheim/Rydex
- Huntington
- IndexIQ
- Invesco PowerShares
- Jefferies
- J.P. Morgan
- Morgan Stanley
- QuantShares
- Pax World
- PIMPCO
- Precidian
- ProShares
- Pyxis
- RBS
- RevenueShares
- Russell
- State Street
- Teucrium
- UBS
- US Commodity Funds
- Van Eck
- Vanguard
- VelocityShares
- Wisdom Tree

Rare earth elements: still digging a hole?

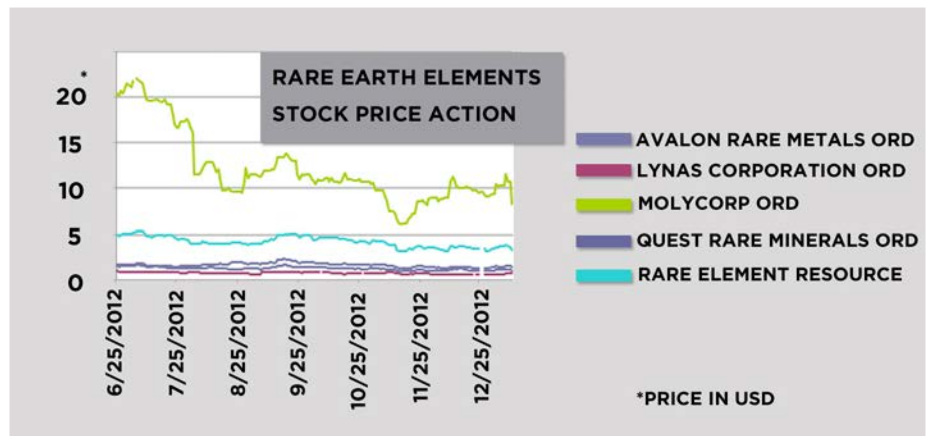
Chris Benedict, vice president at DataLend, discusses the state of the rare earth elements industry

The rare earth elements industry has seen better days. During the year of 2012, the market price of virtually every stock in the rare earth elements industry decreased significantly after the speculative run ups of 2010/2011. The run ups of the previous years can be attributed, in part, to growing manufacturing demand, but the real catalyst was the Chinese government's export ban on rare earth elements, which constricted supply and sent rare earth element prices, and the stock prices of the miners of such materials, skyrocketing to unseen heights. Once the export ban was lifted, those lofty mineral values and stock prices came crashing back down to reality; the market value of many of these rare earth minerals have plummeted by more than 80 percent from their 2011 highs. Is the rare earth mining sector poised for a comeback or will their shares still be digging a hole in 2013?

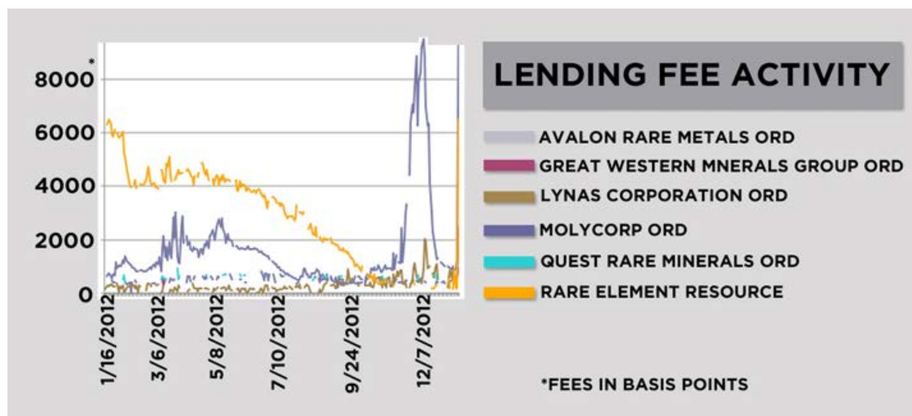
Rare earth elements are a strategic resource comprised of 17 elements in the periodic table that are used in the manufacturing of components used in smartphones, tablets, flat screen televisions, batteries, hybrid cars and other commercial and industrial products that are integral to modern society. Although not exactly 'rare' themselves, these minerals are seldom found in great quantities together in the same geographic location. As a result, mining operations are few, capital intensive, and require prolonged periods of time to come to market.

China has been the dominant rare earth miner for years, producing approximately 95 percent of the global output in 2012 and commanding some 48 percent of the world's known reserves of rare earths. Chinese consumption of rare earths is anticipated to grow by 10 percent per year over the next few years, and as a result, China has begun to import some specific rare earth minerals despite their production dominance, while other countries, deficient in rare earth elements, have taken steps to stockpile them out of fear of future bans. This hasn't helped set a floor for the prices of rare earth elements, which have continued to plunge from their highs of 2011.

It is with this macro-economic background in mind that we start to dive into specific securities.



Molycorp Inc. (MCP), the largest rare earth miner in North America, saw its price collapse from a high of $74.22 in April of 2011 down to a low of $6.13 last year. The stock price, at the time of writing, currently hovers around the $9 per share range, but in the securities lending market it trades with a volume weighted average fee of just over 2000 basis points (bps) after reaching a blistering high of 9200 bps to borrow the security in early December 2012; MCP's current utilisation is approximately 92 percent with 22.6 million shares on loan. Australia's Lynas Corporation fares about the same, trading with a volume weighted average fee of around 550 bps and a utilisation of close to 82 percent with 129.8 million shares out on loan. Avalon Rare Metals (AVL) continues this trend trading at close to 562 bps and a utilisation of 100 percent. Quest Rare Minerals (QRM) trades at a volume weighted average fee of 514 bps and a utilisation of 100 percent as well. Great Western Minerals Group trades at a volume weighted average fee of 1014 bps, but with a lower utilisation of 60 percent. Rare Element Resource (REE) trades a little cooler at a volume weighted average fee of around 225 bps, but the utilisation is still extremely high at almost 99 percent.



Despite the drops of 2012, the overall trends for rare earth element stocks still look fairly bearish for the moment as many of them currently trade with high utilisations and high volume weighted average fees. There may be more downside in the rare earth sector before stock prices truly bottom out. However, macro-economic factors such as a decision by the Chinese government to once again restrict rare earth exports, environmental concerns or possible industry consolidation as a result of low stock prices could send the shorts scrambling to cover as these once high fliers take off again. One thing we can say for sure is that rare earth element miners will remain volatile in 2013 and beyond, offering trading opportunities for the longs and shorts alike.

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Va Va Voom or doom?

Was the turn of the year a cause for celebration or more of the same for battered and bruised financial markets? David Lewis of SunGard Astec Analytics takes a look

There is a rich history of politicians and economists calling a recovery, of seeing the 'green shoots' of new growth as it were, only to face a new market crash after their ill-timed comments. While it may be premature to make such calls now, it is fair to say that there was a short bout of exuberance at the start of this year, with even the European Central Bank (ECB) heralding "financial market normalisation". Was this just the excitement of the New Year, or is there real evidence of some good news around the corner?

Several positive indicators have already been seen lurking around the industry. In the UK, the FTSE 100 is back to levels not seen since before the Lehman Brothers default. The S&P 500 and the DAX can also claim the same recovery of value since that watershed moment. Languishing behind are France and Japan—the CAC 40 and the Nikkei 225 are only at 73 percent and 75 percent of their 2008 peaks respectively.

Much of the positive momentum has been deemed the result of the Chinese economy continuing to grow, albeit more slowly, notching up record imports of crude oil, iron ore and copper in 2012. Much of the negative drag on world economies have been levied at the eurozone where demand levels continue to fall.

The effect on the fortunes of companies that are exposed to these very different markets has been ably demonstrated by news from Honda and Jaguar Land Rover in January—in the UK, Honda is shedding 800 jobs in Swindon due to falling demand in Europe while Jaguar Land Rover announced the recruitment of 800 staff in Solihull to meet the record demand from China for its premium brand of Land Rover vehicles, which is up 70 percent year-on-year.

What have short sellers been making of the outlook for 2013? Comparing on-loan volumes across the last 12 months across a selection of the world's largest economies can give an indication of sentiment. Figure 1 shows the indexed total volume of shares on loan across four main indices. It is clear from the graph that Germany is the 'Jaguar Land Rover' of this group, seeing its total shares on loan falling around 65 percent from a year ago. The CAC 40 is also net down, but only by 15 percent and this is the only time it has fallen below 100 since April 2012. Ignoring the clear dividend yield peak of April and May, the CAC 40 has seen much greater volumes on loan during 2012. With new taxes, industrial unrest as well as political battles to fight, it is difficult to see why shorting demand has dropped off in France.

The FTSE 100 has fared a little better during 2012 with some fairly volatile peaks, particularly in May and August. Finishing with only a 4 percent reduction of shares on loan compared with a year ago, it seems that market sentiment on the FTSE 100 has shown no net change. The 'Honda' of this group is the S&P 500, with a near 6 percent rise in shares on loan compared with one year ago. The S&P shows a net gain of 10 percent over five years, is now 3 percent over its 2008 peak and within 7 percent of its all-time high point (October 2007). It seems that over the last 12 months, net negative sentiment has risen.

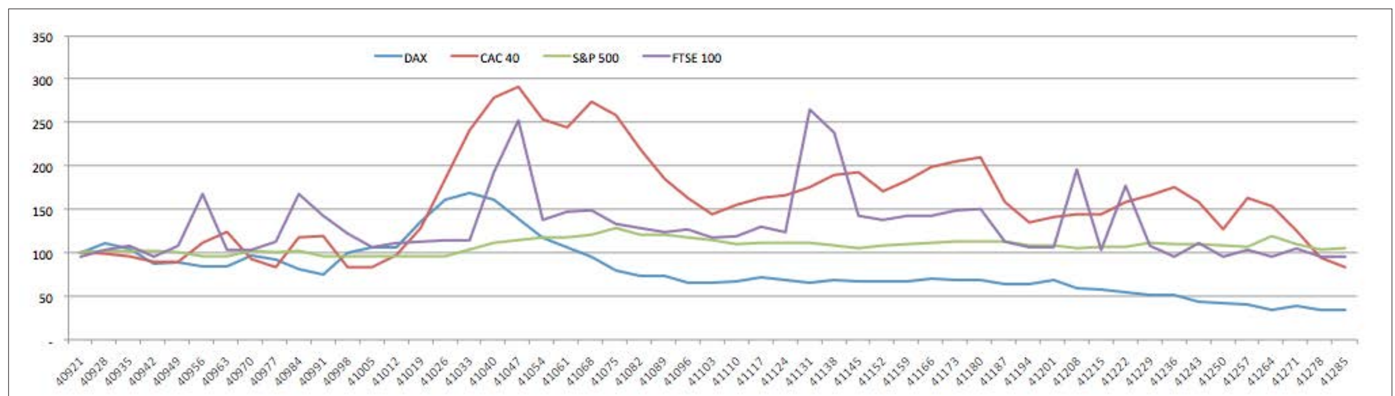
During 2012, the number of shares on loan in the S&P had net risen, slightly higher than 10 percent, falling from more than 20 percent higher just before Christmas. The expectation that the Fiscal Cliff issues would be averted is said to have been the cause of this decline, a positive outcome being expected to have a lifting effect on share prices. As anticipated, the index rose 2.5 percent in value on 2 January, dragging many other world indices along for the ride. However, the bounce was short-lived and immediately after the New Year, balances on loan started to rise again.

Is this rise due to an expectation of further trouble ahead as the US legislature continues to wrangle over taxes and spending, or is it an accurate reflection of rising negative sentiment toward the longer-term value of the S&P 500? Whatever the details of the agreements that were made on Capitol Hill, it is clear that taxes will rise and spending will fall in some form or other, both of which will contribute to depressing demand and fuelling negative sentiment.

January will see how these diverging pressures play out, and February may prove another major hurdle for the U.S. economy—negotiations over the $16.4 trillion debt ceiling will come more into focus, bringing further pressures to the markets. On that basis, perhaps the green shoots are not sprouting everywhere. **SLT**

David Lewis
Senior vice president, Astec Analytics
SunGard's capital markets business

Figure 1: Shares on loan indexed to 13 January 2012; data: Astec Analytics



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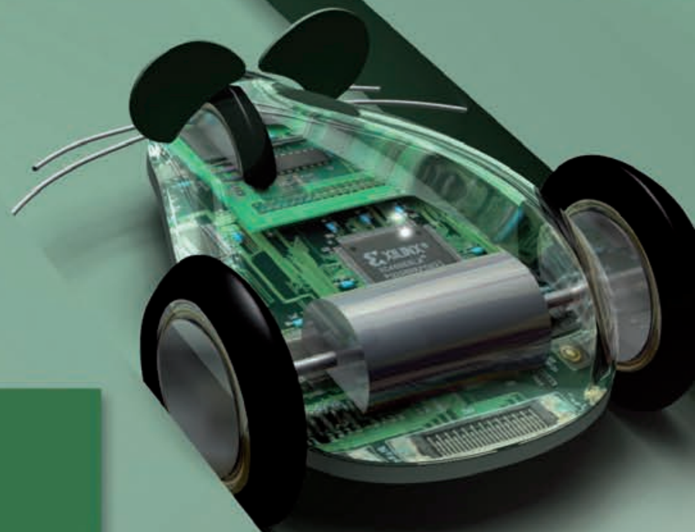

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Industry appointments

Alison Phillips has been appointed to the financial markets business of ING as director of global securities finance sales for Europe.

Reporting to Richard Pryce, she previously worked at Goldman Sachs.

ING reportedly merged cash equities, equity derivatives and global securities finance into one unit in January 2012 in a bid to boost sales and cut costs.

The new unit includes part of the equity capital markets business, excluding mergers and acquisitions. The integration will reportedly take two to three years to be completed.

S3 Partners has appointed **Jose Fernandez** as managing director and global head of business development and client service.

S3 provides independent solutions, insight and advice to manage counterparty risk and financing costs for asset managers and financial institutions.

Fernandez joins S3 from Goldman Sachs after 26 years at the firm. He was part of the founding of the prime brokerage business and was a managing director responsible for co-managing the prime brokerage client services team in the US.

Bob Sloan, founder and managing partner of S3, said: "Fernandez has been at the epicenter of the most essential service provided to assets managers in his previous role in prime brokerage. His expertise will be a critical resource for our clients and a catalyst for the S3 team."

Fernandez said: "I was attracted to S3 as a firm because of its reputation as a trusted advisor to its clients. New regulation requires asset managers to assess and evaluate counterparty risk and cost in their businesses."

"After working closely with the S3 team, I am extremely impressed with their approach as well as the effectiveness of the service offering, which has been adopted by the largest and most sophisticated asset managers in the world."

Paladyne Systems, a Broadridge Financial Solutions company, has appointed **Jim Feingold** to the role of global head of sales.

Joining the sales and business development team as senior hires are **Devani Maijala**, **Lisa Zippelius** and **Michael Conti**.

Feingold will developing buy-side relationships directly with hedge funds, asset managers, service providers and channel partners, as well as supporting Paladyne sales into adjacent markets.

Maijala joins Paladyne as a senior director of sales and will focus on expanding relationships with global hedge fund administrators, and Lisa Zippelius joins Paladyne's New York office as a senior director of buy-side sales and will focus on prime brokerage.

Zippelius spent nine years at Goldman Sachs where she was most recently a vice president in the prime brokerage group as a trader on the securities lending desk.

Conti joins Paladyne as senior director of sales and will cover direct sales to hedge funds and asset management clients in the US.

A source confirmed that **Charlotte Burkeman**, EMEA head of prime brokerage at the Bank of America Merill Lynch, is leaving the firm due to personal reasons.

Burkeman previously held roles at UBS Securities and Goldman Sachs. Bank of America Merill Lynch declined to comment.

The National Association of Pension Funds (NAPF) has appointed Helen Roberts to lead its work on investment issues.

Roberts joined the NAPF from F&C Asset Management, where she was head of government bonds for more than 13 years. Previously, she was head of UK gilt and inflation-linked bonds at Hermes Investment Management.

Led by policy director Darren Philp, her work will include considering the implications of the economic outlook for funds when trading off risk and return, and deepening the NAPF's awareness of alternative asset classes and the diversification strategies being used by pension funds.

Philp said: "We are delighted that Roberts has joined us at a time when a lot of change is taking place in the pensions world. Her wealth of experience will be an invaluable boost to our policy work on investment."

Brokerage firm Grace Financial has hired **Gerard Lennon** for the new position of president.

Grace Financial is a brokerage firm specialising in prime brokerage services and custom execution services to institutional clients and high net worth individuals.

Lennon, who has been with Grace Financial Group for the last six years, brings to the position his more than twenty years of institutional sales and brokerage experience.

RBC Investor & Treasury Services has appointed **Tony Johnson** and **Joanna Meager** as co-heads of its investor services business.

Johnson, who is global head of sales and distribution, and Meager, who is global head of client operations, will continue in their current roles in addition to their new positions.

Meager and Johnson take over from José Placido, CEO of RBC Investor Services, who has announced his departure, which comes into effect on 28 February 2013, after more than 24 years at the firm.

Both will report to Harry Samuel, head of RBS Investor & Treasury Services, which is the new RBC division comprised of global financial institutions, investor services and treasury services.

Samuel said: "Johnson and Meager each have an outstanding track record within RBC Investor Services and, as such, are both extremely well placed to maintain our exceptional client service experience."

"As co-heads of our investor services group, Johnson and Meager will combine their complementary skills and contribute significantly to the broader strategy for RBC Investor and Treasury Services, which is to be a specialist provider of investor services, treasury and payment services." **SLT**

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