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Europe's highest court names a date for UK short selling challenge

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A UK challenge to the extended authority of the European Securities and Markets Authority (ESMA) under the EU Regulation on Short Selling will be heard in the Court of Justice of the EU (CJEU) on 11 June.

The UK filed its complaint with the CJEU on 1 June 2012, challenging Article 28 of the short selling regulation.

The short selling regulation requires holders of net short positions in stocks or sovereign debt to notify regulators when certain thresholds are breached, and places certain restrictions on investors when entering into uncovered positions.

It also gives regulators the power to suspend short selling or limit transactions when the price of various instruments, including stocks, sovereign and corporate bonds, and exchange-traded funds, fall a set percentage from the previous day's closing price. The regulation came into effect on 1 November 2012.

The UK is contesting Article 28 because it gives ESMA too big a mandate, according to the complaint.

Article 28—"ESMA intervention powers in exceptional circumstances"—allows the agency to prohibit or impose conditions on who can conduct short selling, and require short sellers to publicise any positions.

The power that this gives to ESMA goes above and beyond EU treaties, said the UK in its complaint.

Article 28 confers on ESMA "a large measure of discretion" and "the factors which ESMA must take into account contain tests which are highly subjective", argued the UK.

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FTSE peaks, but short interest holds out for corrections

The FTSE 100 has hit its highest level since September 2000. The index finished 32.57 points higher at 6755.63, surpassing a peak of 6732 seen in 2007.

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iTalk threatens Berlin stock exchange with legal action

The mobile communications company iTalk has informed its investors that the company's shares have been listed on the Börse Berlin Stock Exchange without its approval, in a strongly worded release.

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CJEU names a date for UK short selling challenge

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It added: "ESMA is empowered to renew its measures without any limit on their overall duration."

Removing Article 28 from the short selling regulation would leave the remainder of it largely intact, the UK concluded.

Certain other EU Member States and industry leaders have also flagged up ESMA's interventionist powers.

The Czech Republic have stated that it cannot support Article 28 and suggested that it would contravene the principle set out in the CJEU's Meroni judgment.

"The Meroni doctrine is used to determine the extent to which the European Union can delegate its powers to agencies," said an article by Irish law firm Dillon Eustace.

"It is possible that a person affected by the use of this power could take an action to challenge ESMA's authority in the European Court of Justice."

The law firm went on to advise that market participants must reassess their investment strategies that use short sales of EU-listed shares and EU sovereign debt.

"For the most part, the EU Short Selling Regulation and its Level 2 Regulations are not retroactive, meaning that all uncovered positions in a sovereign CDS entered into before 25 March 2012 may be held until maturity."

"Any positions entered into between 25 March 2012 and 1 November 2012 are permitted but were required to be unwound before 1 November 2012 unless they fell within the hedging exemption above."

FTSE peaks, but short interest holds out for corrections

Continued from page 1

Royal Bank of Scotland was the day's biggest riser, with the bank ending up 15.1p higher at 351.9p and Fresnillo fell the most, down 35p at £10.34.

Stock markets globally have seen good gains recently—the US S&P 500 and Dow Jones Index have been trading at record highs, as has Germany's Dax index.

Reasoning behind FTSE's highs were given as reasonable US consumer confidence figures, as well as the recent news that Japan raised its outlook for the economy.

Some analysts have expressed concern that gains are being propelled by market sentiment rather than earnings, with many warning that investors should expect a correction.

David Lewis, head of EMA stock lending at Sungard's Astec Analytics, said that in the run-up to the record high for the UK market, the value of stock on loan has fallen by a fifth in the last month.

"However, though many traders have closed out short positions, short interest remains 40 percent higher than the average of the last 12 months, suggesting that a lot of people are betting on a correction."

iTalk threatens Berlin stock exchange with legal action

Continued from page 1

Based on other recent unauthorised listings on the BBSE, the company stated, it believes that the listing is the first step in what will be a "significant naked shorting attack" directed at the company.

It added that on 26 April, another OTCQB traded company, Lot78, announced that a similar naked short selling tactic had been used to potentially negatively manipulate the price of its common stock.

Subsequently, after bringing the scheme to an apparent halt, short sellers were caught in a "short squeeze".

Lot78 is a unisex clothing brand whose stock experienced a 400 percent rise in April after an aggressive marketing campaign. As an ongoing business entity, it has zero revenue and net losses of $38,000 for the most recent reported quarter.

ITalk went on to state that its legal counsel will be contacting the BBSE and the broker sponsoring the listing to demand that its stock is immediately delisted.

"The company reserves all rights to pursue legal action against the broker sponsoring this listing and any market maker that has engaged in naked short selling in direct violation of Regulation SHO."

The BBSE is one of the few stock exchanges in the world that allows listing and trading of a company's stock without the consent or authorisation of the company being listed.

ITalk is a wireless technology value-added reseller, and focuses on the development and launch of technology and products in the communications markets. The company focuses on the marketing and distribution of its iTalk phone devices. It provides wholesale and retail telecommunications services, and products worldwide. The company was formerly known as Sopac Cellular Solutions.

Most recently, it signed a letter of intent to acquire the assets and business of Global Telelinks, a 10-year-old international telecommunications company.

Turkey's government bonds move up a notch

Moody's Investors Service has today upgraded Turkey's government bond ratings by one

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notch to Baa3 from Ba1, and has assigned a stable outlook.

The reasons for the rating action were recent and expected future improvements in key economic and public finance metrics, as well as progress on structural and institutional reforms that Moody's expects will reduce existing vulnerabilities to shocks to international capital flows over time.

The first driver underlying Moody's decision to upgrade Turkey's sovereign rating to Baa3 is the improvement in the country's economic and fiscal metrics.

Since the beginning of 2009, Turkey's debt burden has fallen by 10 percentage points to a manageable 36 percent of GDP, and Moody's expects this decline to continue in the coming years.

The maturity profile of the central government's debt stock has also lengthened significantly to 4.6 years (and the maturity of its foreign debt stock is now over 9 years), which reduces its vulnerability to interest-rate increases.

Moody's also indicated that the government's revenue streams have demonstrated resilience in recent years.

"For example, even in the face of contraction in real GDP growth by 4.8 percent in 2009, general government revenues increased by over two percentage points in that year and have remained on an upward trajectory since that time."

"These improvements, when considered in conjunction with the size, wealth, and diversification of the domestic economy, increase the sovereign's ability to withstand a crystallisation of balance of payment risks over the short to medium term."

The second driver of today's rating action is the progress that the government has made on a wide-ranging institutional reform programme that Moody's believes will gradually erode the country's external vulnerabilities over a longer time horizon.

The government's policy actions are addressing the role that energy plays in driving up the current account deficit, the weak savings rate and the country's overall competitiveness. Taken as a whole, this reform agenda reflects that the government is taking action to address these vulnerabilities.

According to Moody's, upward movement in Turkey's sovereign rating will be constrained by balance-of-payments factors while external imbalances remain large. Upward rating pressure could materialise in the event of structural reductions in these vulnerabilities or further improvements in Turkey's institutional environment or competitiveness.

Reductions in political risk that may emanate from progress on the peace process with the Kurdish insurgency, while credit positive, would not result in upward rating action in the absence of other credit improvements.

Moody's would consider downgrading Turkey's sovereign rating if improvements in the public finances were to be materially reversed. A sudden and sustained halt in foreign capital flows would also exert downward pressure on the rating.

ConvergEx to relieve tax burdens for prime clients

ConvergEx Group's prime brokerage unit has launched Tax Optimizer to improve client control over tax liabilities.

Clients of ConvergEx Prime Services, which include hedge funds, family offices, mutual funds and investment advisors, will be able "to better understand and customise their tax lot closing methods", enabling capital gain and loss allocations to be itemised "in a more efficient manner".

"We maintain a constant effort to offer products that stay one step ahead of our customers' needs," said Douglas Nelson, CEO of ConvergEx Prime Services. "While the 2013 tax reporting season may seem like a far off event, customers would be wise to begin planning for it now so they are fully prepared come next April."

J.P. Morgan to launch a global convertibles income fund

J.P. Morgan Asset Management is set to launch a global convertibles income fund that promises investors high income with the potential for capital growth from a portfolio of global convertible securities.

The new Guernsey-domiciled, but London-listed investment company will access convertible securities from around the world. Convertibles offer investors bond-like characteristics in falling equity markets with the potential to participate in rising markets.

The company will initially target a gross 4.5 percent annual dividend and will be managed by J.P. Morgan Asset Management's convertible bond team, headed by Antony Vallee.

The investment company structure aims to allow greater freedom to invest in new issues, and small and mid-cap issues where liquidity constraints restrict the ability of rival open-ended funds to invest.

Antony Vallee, head of convertibles at J.P. Morgan Asset Management, said: "There has been a growing interest in convertible bonds as investors search for yield."

"This, coupled with the rising trend of established companies around the world turning to convertible bonds as a way of raising cash, means that we believe the time is right for this investment company. This is global equity income for the cautiously optimistic."

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look to convertibles to provide them with a well-diversified global portfolio and comfort in an unsure market.

"For some investors convertibles are becoming an attractive financial instrument to allow them to take a step from bonds to equities. By employing J.P. Morgan's well-developed convertible bond investment process, we aim to provide investors with exposure to a breadth of strategies and to the full range of the global convertible bond universe, including the important new issue market. This is an area of the market that existing open-ended funds cannot fully capitalise on as they need to carry liquidity."

Simon Crinage, managing director and head of investment trusts at J.P. Morgan Asset Management, said that now was the ideal time to launch the company. "Convertibles performed well in 2012 and we believe this is set to continue. The company will focus on quality bonds that ensure investors get the benefits of stock market upturns but with the protection of bonds: superior risk-adjusted total returns and reduced volatility."

"Our dedicated convertibles team has managed convertibles since 1995 and, with nearly $5 billion under management, we are one of the world's largest convertible bond investors."

Full details of the investment company will be available shortly.

Not much securities lending left in Switzerland, suggests Swisscanto

The dramatic events that took place in the capital markets in 2008 have led pension institutions to rethink their approaches to securities lending, said Swisscanto in a survey report, adding that the practice was largely being withdrawn from in Switzerland.

The Swiss asset manager and fund provider—well-known for its annual Swiss pension funds study—said in its survey report that many funds are aware that the supposedly risk-free and temporary lending of securities contained dangers hitherto barely considered, such as counterparty risks, for which it may not be possible to compensate due to relatively low earnings.

Surveys on this issue have shown that smaller pension institutions have now largely withdrawn from securities lending and that many of the larger funds with more than 1 billion Swiss francs in assets have also given up a significant part of this business, it said.

An industry event earlier in the year found that Swiss pension funds were facing low lending fees and were concerned about reputational risk.

Swisscanto's survey also showed that pension funds are acting in a far more cost-effective fashion through being careful to keep expenses under control and to use any opportunities to make cost savings, both in general administration and capital investments.

"In fact, the costs identified and their development in the last few years are quite impressive," stated Swisscanto in its survey report.

"Since 2007, the total expenses for capital investments and administration of insured persons have been reduced by the smallest funds with less than 250 beneficiaries by almost 40 percent per head on average, from around 1170 to 720 Swiss francs, whilst the largest funds with over 10,000 beneficiaries have reduced their expenses per head by 20 percent from 430 to 345 Swiss francs, a similarly impressive amount in view of their significantly lower cost base."

Short selling bans don't influence herding

The Centre for International Governance Innovation (CIGI) has released a publication

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detailing the effects of short-sale constraints on herd behaviour.

The publication examined bans on selected financial stocks in six countries during the 2008-2009 global financial crisis, which provided a setting to analyse the effect of short-sale restrictions.

"The literature on short-selling restrictions focusses mainly on a ban's impact on market efficiency, liquidity and overpricing," said authors Martin Bohl, Arne Klein and Pierre Siklos.

"Surprisingly, little is known about the effects of short-sale constraints on herd behaviour. Since institutional investors have come to dominate mature stock markets and rely extensively on short sales, constraining these traders may influence the asset pricing process."

The authors' empirical evidence showed that short-selling restrictions exhibit either no influence on herding formation or induce adverse herding.

They cited another publication by Hwang and Salmon in 2004, which addressed the case of stock market herding and revealed a tendency of investors to reduce their herding or even to switch to adverse herd behaviour during periods of crisis, while regular herding is more likely to arise during calm times.

Seeking a theoretical explanation for these findings, Hwang and Salmon (2009) address swings in herding behaviour related to time-variations in market sentiment.

In particular, investors are prone to regular herding when they broadly agree about the stock market's future performance, while adverse herd formation is the consequence of a high level of divergence of opinion among market participants.

The authors stated that they do not support the notion that herding among institutional investors was an important phenomenon during the global financial crisis.

"This implies a higher dispersion of returns around the market compared to rational asset pricing, which can be interpreted as an increase in uncertainty among stock market investors." The Centre for International Governance Innovation (CIGI) is an independent, non-partisan think tank on international governance.

Risk assets are prevalent in US triparty repo, says Fitch Ratings

Risk assets remain noticeable in US triparty repo, said Fitch Ratings after its analysis of data from the Federal Reserve Bank.

Fitch Ratings' analysis of newly released data from the Federal Reserve Bank of New York (FRBNY) showed that, as of 9 April, almost $300 billion in non-government securities were financed through the US triparty repo market—a level that has remained relatively constant over the past few months.

Senior government officials and agencies have been warning about the potential systemic risks of funding less liquid assets through short-term wholesale funding markets, such as triparty repo, said the ratings firm.

"Importantly, while FRBNY data and money market fund disclosures help to shed light on the risk attributes of the triparty repo market, there is much less information available on the more opaque bilateral repo market, whose overall size remains unclear and is the subject of ongoing research and debate."

The roughly $300 billion in non-government repo collateral consists of about $109 billion in equities, $68 billion in corporate bonds, and $76 billion in structured finance (with the remaining $44 billion in collateralised debt obligations, municipals, and whole loans, among other securities).

Triparty repo remains an important source of funding for a range of asset classes, including treasury and agency securities, which make up the balance of the $1.79 trillion US triparty market.

For context, Fitch added, the $76 billion in structured finance securities is typically 10 times greater than average daily trading volumes for this asset class.

According to Fitch's recently published analysis of the 10 largest US prime money market funds' (MMFs) disclosures, structured finance repo collateral typically comprises deeply discounted, small-sized legacy securities.

More than half of Fitch's structured finance sample consists of legacy-era subprime and Alt-A RMBS and CDOs. Additionally, Fitch's research indicates the generally small size of many of these securities, which could make it difficult for holders to either fund or liquidate them during periods of market distress.

Yield differentials likely help to explain the persistence of structured finance repos. Fitch's data indicates that, as of the end of December 2012, repos backed by structured finance securities yielded approximately 63 basis points (bps) per annum, contrasted with the 17 bps yield on repos backed by treasurys.

Given the continuing low-yield environment, these higher returns are likely attractive to some money funds, which focus primarily on the strength of the counterparty rather than on the collateral when entering into these types of repos.

For securities dealers, repos provide a source of cost-effective funding, particularly given the low credit quality, small size, and longer-tenor of many of the underlying securities.

That said, senior government officials and policymakers have recently pointed to the potential systemic risks of funding longer tenor assets through the short-term wholesale funding markets.

In a May speech, FRBNY governor Daniel Tarullo said: "Repo, reverse repo, securities lending and borrowing, and securities margin lending are part of the healthy functioning of the securities market."

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"But, in the absence of sensible regulation, they are also potentially associated with the dynamic ... of exogenous shocks to asset values leading to an adverse feedback loop of mark-to-market losses, margin calls, and fire sales."

Similarly, the Financial Stability Oversight Council's recently-published annual report for 2013 cited "fire sales and run risk vulnerabilities" as a potential emerging threat, noting that, for triparty repos, "the risk of fire sales is heightened when collateral is less liquid."

As Fitch has highlighted in prior research, the use of repo to fund less-liquid assets creates potential risks for both triparty repo borrowers (ie, dealer banks) and the underlying asset class.

Money funds, which act as repo lenders, are short-term, highly risk-averse investors. Repo funding for structured finance assets essentially evaporated at the height of the US credit crisis, a loss of liquidity that likely contributed to the steep valuation declines in this asset class during that period.

TFL pension fund keeps trust in J.P. Morgan

Transport for London (TFL) Pension Fund has reappointed J.P. Morgan as global custodian for all its managed assets, and for the first time J.P. Morgan will also provide performance measurement services.

TFL Pension Scheme has approximately £6.8 billion of assets under management.

J.P. Morgan has acted as global custodian for the scheme since 1999 and has provided securities lending services since 2000.

Let's revisit single stock futures, says Finadium

Alternatives for financing positions are getting a more receptive hearing than ever before, declared Finadium in its May report.

In the report, the securities lending consultant makes the case for single stock futures (SSFs), and considers reasons for prime brokers and beneficial owners to evaluate these equity-linked derivatives as a revenue opportunity, as well as "the resistance that SSFs still produce in the prime brokerage market".

The mechanics of SSFs to help determine the role of this product in the market for prime brokers and beneficial owners in securities lending were also discussed.

Though SSFs generally operate by regular rules of futures markets and are widely traded, especially in European markets, in the US these products have been the subject of much debate and wrangling over regulatory oversight between the SEC and CFTC, said Finadium.

"At the same time, centrally cleared SSFs fit a key requirement as banks move towards compliance with Basel III and other regulations. For the first time in many years, the future looks bright for the US's only exchange, OneChicago, and only very recently are we hearing major hedge funds and other asset managers seriously consider these listed derivatives as opposed to conducting a trade on equity markets."

The report also looks at the fortunes and workings of OneChicago in light of new regulatory pressures on bank balance sheets.

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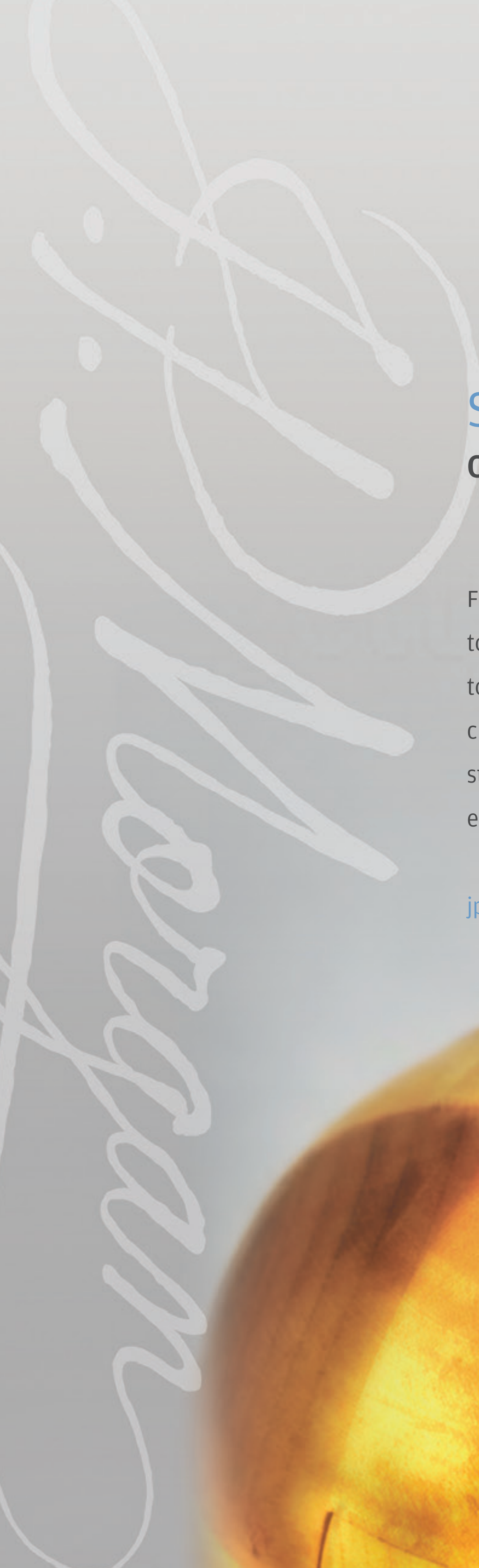

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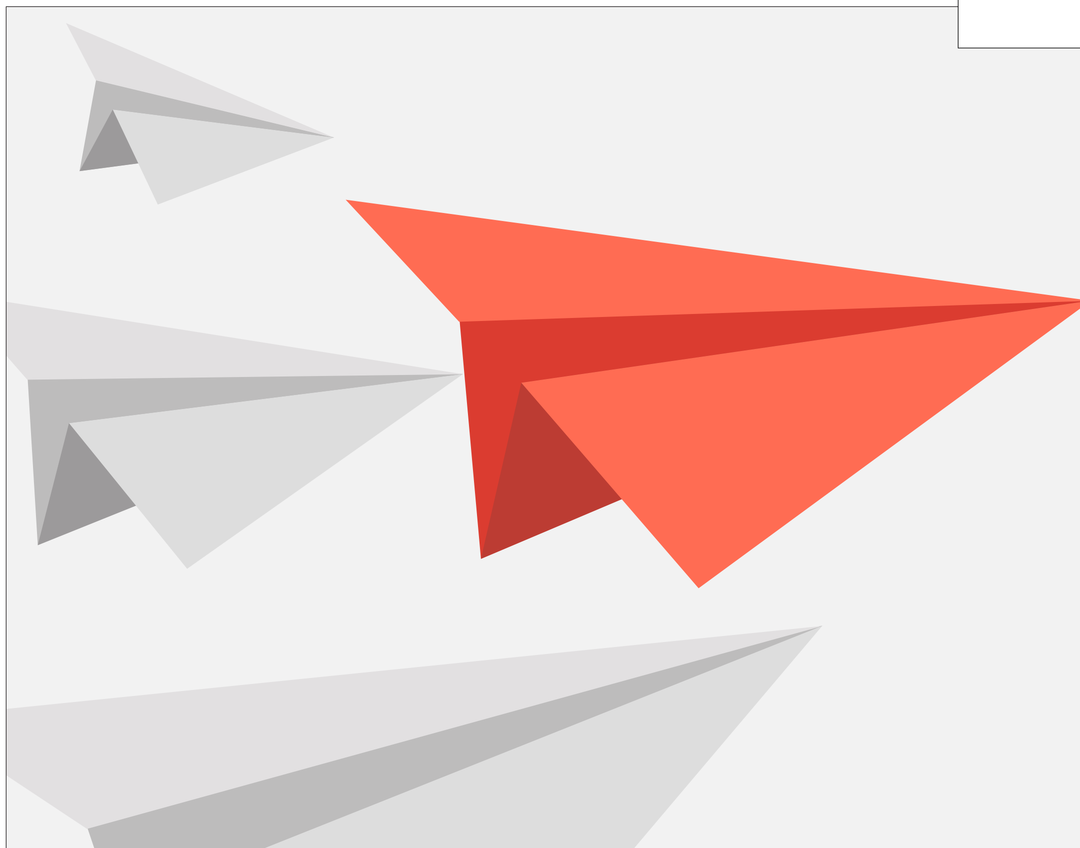

MTS to launch bond platform for US institutional investors

MTS, a European electronic fixed income marketplace, is to launch a platform for US institutional investors.

The platform aims to enable buy-side participants to directly access real-time pricing from what it calls "one of the deepest liquidity pools in Europe" for the first time, and execute European and US government, agency, mortgage, and corporate bonds with major dealers.

MTS Markets International has been approved as a FINRA-regulated broker-dealer, and has appointed Mark Monahan as its chief executive. Monahan was previously CEO of Ballista Securities (acquired by the Intercontinental Exchange in 2011) and CEO of ICAP Electronic Brokerage in Asia Pacific.

Jack Jeffery, CEO of MTS, said: "Building out our fixed income presence in the US is a natural extension for MTS and London Stock Exchange Group. By expanding the reach of our pricing and trade execution, we are not only responding to the on-going regulatory push for greater transparency and efficiency, but providing an attractive, competitive and cost-effective alternative to an important community of institutional investors."

Monahan added that increasing regulation, alongside continued uncertainty in the sovereign and credit markets, has accelerated the demand for more efficient, informed and connected execution venues.

"MTS is ideally positioned to answer this need by providing institutional investors with a transparent window into the European marketplace."

MTS will initially offer European and US government, agency, corporate and covered bond markets. These services will immediately access pricing and liquidity from the dealer-to-client platform MTS BondVision.

Euroclear partners with DTCC; Clearstream to follow

Euroclear and The Depository Trust & Clearing Corporation (DTCC) have signed a MoU to create a joint collateral processing service that hopes to significantly increase efficiency, reduce risk and support the growing collateral needs of industry participants.

Initially, the joint services will offer automatic transfer and segregation of collateral based on agreed margin calls relating to OTC derivatives and other collateralised contracts.

"This will significantly reduce settlement risk, increase transparency around collateral processing on a global basis and will provide maximum asset protection for all participants," said a statement from Euroclear. DTCC and Euroclear will also establish mutual links, permitting firms to manage collateral held at both firms' depositories as a single pool.

The joint service, stated the release, will be operated as an "industry cooperative" and will provide open and non-discriminatory access to all other collateral processing providers, including custodians, central securities depositories (CSD) and international CSDs, that wish to link their services to the joint service.

Tim Howell, CEO of Euroclear, said: "As demand for collateral increases, both DTCC and Euroclear are each developing our own means to ease collateral sourcing and mobilisation for clients. Euroclear's global Collateral Highway is a key part of our strategy to deliver such an infrastructure."

"The industry is focused on collateral management as a result of concerns over how to address operational and counterparty credit risk while navigating the changing regulatory landscape," said Michael Bodson, DTCC's president and CEO.

"DTCC's Margin Transit Utility, currently under development, will help mitigate risks, lower costs and create greater efficiencies, by providing straight-through-processing to help satisfy obligations of clients. We look forward to leveraging the strengths of both institutions to meet the collateral needs of industry participants."

A source also reported that Clearstream will soon announce a similar arrangement with DTCC. The clearing firm announced a partnership with DTCC in November 2011, whereby it would leverage DTCC's Loan/SERV Reconciliation Service and offer it in the first half of 2012.

Plans were also made to develop bilateral loan services, built on DTCC's existing Loan/SERV platform and integrated with Clearstream's collateral management platform.

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Economy drive

Shinzo Abe hopes his stimulus package will revive the Japanese economy, but will the lending industry benefit? SLT finds out

GEORGINA LAVERS REPORTS

Aggressive stimulus measures in Japan have meant good things for the country. Its economy—the third largest in the world—expanded at its quickest pace in a year, with GDP rising 0.9 percent in the three months to March compared to the previous quarter.

The government recently upgraded its assessment of the economy, and it looks as though the country is recovering after a recession that left exports and factory output at a miserable level.

The key driver for this change, say analysts, is Prime Minister Shinzo Abe's aggressive policies, called 'Abenomics'. Abe launched a 10.3 trillion yen ($110 billion) stimulus package in the beginning of 2013, one of Japan's largest, and thought to be the beginning of the end of two decades of economic sluggishness.

The talk around growth does not seem to be mere chatter, though. Sony garnered its first annual profit in five years this month, and Toyota tripled its earnings. Sony has also proved a fruitful source of rumours concerning its entertainment division. Karl Loomes, a market analyst at SunGard Astec Analytics, says: "There has been talk on and off this year that Sony's entertainment arm would make a strong acquisition target if it were to be spun-off, but so far Sony have adamantly said this will not be the case."

Loomes adds that another big move recently came when Sumitomo Mitsui agreed to buy 40 percent of Indonesia's Bank Tabungan Pensiunan Nasional, but states: "As far as lending opportunities are concerned, so far we haven't seen any significant changes to borrowing levels or costs coming on the back of this."

M&A activity aside, there are hints that the Japanese market has been considering the implications of the sector as a positive force for the country. Loomes states that a lot of focus in recent months has been looking towards some easing off on the rules concerning short selling.

"In March, the Japanese Financial Services Agency said that although they will be making the naked short selling ban permanent, and making some changes to the reporting and disclosure rules, they will also be removing the uptick rule (or at least only making it come into action after a 10 percent fall in price)—and it is this point that many are looking to."

Loomes adds that numerous studies, including one of SunGard's, show that limiting short selling can actual hinder the markets. "Looser rules would be expected to bring about increased liquidity in both the cash and securities lending market, as well as helping price transparency and often increasing demand to borrow securities. The one caveat with these changes however, is that they are due to come into play in November, and so the impact at this stage is anticipation rather than realised changes."

A demanding presence

Japanese government bonds have recently—and surprisingly—fallen in value, with the yield on the benchmark 10-year Japanese government bond (JGB) surging to 0.92 percent in May.

"We have been observing a steady increase in borrowing fixed income securities in the country from around the start of March—most of which seems to be coming specifically from increased borrowing of government bonds," says Loomes.

"Assigning all of this increase to falling prices would be an overstatement, however bond lending and borrowing is often done with the actual cash value of the transactions in mind, and so lower prices would need to be matched by increased levels in terms of units."

In terms of markets, says Loomes, demand to borrow shares has seen little change from the norm, in that the wholesale market still by far sees the largest volumes compared to say retail or broker to broker. "One change that we have been observing in recent months, however, is in the reasons behind the demand to borrow shares in Japan."

"Specifically we have seen falling demand to borrow specials, while at the same time borrowing volumes of general collateral have actually increased. Even with the country's short selling limitations, we would expect decreased borrowing of specials to represent a more optimistic view of the market (for example, with less short hedging against long position), while general collateral stock borrowing tends to be used for the more day to day activities such as trade settlement."

As for asset classes, fixed income has seen a general increase in borrowing since early March, much of which seems to be coming in government bonds, says Loomes.

"Some of the most interesting stories are actually for individual securities. Sharp Corp, for example, has been one key stocks that we have seen coming up time and again over the past six months, with seemingly non-stop news flow keeping interest high from borrowers and short sellers. Levels of borrowing have more than doubled over the last 12 months, while the cost of borrowing has climbed out of safe general collateral territory, moving deep into the specials range—peaking just last month at almost 17 percent per annum. Even now having pulled back somewhat, its cost of borrowing is one of the highest we see for Japanese equities." SLT

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Refining the legacy

While CIOs despair at the thought of such upheaval, refreshing legacy systems can be vital to a bank with a problematic data setup, as SLT discovers

GEORGINA LAVERS REPORTS

Like many technology buzzwords—'the cloud' being one that immediately springs to mind—a legacy system is a phrase that is used a lot to describe a number of things tech-related.

Adrian Morris, head of MX Consulting and a specialist in securities finance, says that his company would define a legacy system—whether proprietary or vendor—as an old method, technology, computer system, or application.

"For many, legacy systems are those that have been inherited in the past when businesses have merged. Not all are bad, many do the job very satisfactorily but it is well known that many institutions have found their application estate becoming ever more complicated to manage as the number of legacy systems have multiplied over the years."

There are two main approaches to the refreshing or re-platforming of legacy systems. The first is to replace the solution entirely; akin to cutting the rot out of a tree.

"Replacement should always be considered as one option when a platform needs a refresh," comments Dipak Patel, a partner at Delta Capita, a technology consultancy firm for commercial and investment banks. "A business case will determine whether it is realistic or not, and it depends on the scope of the required change. We have a proven approach for software or solution replacement, usually starting with a review of the business operating model, so as to ensure requirements are in line with current business drivers."

If re-platforming the solution is too expensive or difficult, then a functional refresh and technical re-platforming is another option. Patel says: "A refresh or re-platforming is an option when there are specific functional or technical issues that can be addressed with a limited-scope change to the solution, eg, from moving to a mainframe-based system to Windows-based system."

"Delta Capita manages programmes and projects in this space. Our technical project and programme managers lead engagements using various technologies and vendor packages. We also have very senior business analysts and architects who can get involved especially in the earlier stages of a project, to analyse and design solutions, and to help guide the implementations."

But the main obstacle prior to any re-platforming or refreshing is the jump that executives must make in first deciding to change a technology platform that may have been in place for decades. Chief information officers at banks tend to switch around different firms every couple of years, and can therefore be unwilling to take on such a large project that doesn't have the fastest of results. Also, though the value of deals in Q1 2013 declined 38 percent from $12.2 billion in Q1 2012, with fewer large transactions, general widespread merger and acquisition activity in the last year has meant that some banks have scores of different legacy systems.

Klaus Holse is the CEO of SimCorp, a provider of investment management software solutions. He says that, among other reasons, a fear of change is the biggest hurdle to jump. "Many institutions have been relying on the same platform for years. Their staff are trained in using it, they know the workarounds and perhaps the system is connected into many other systems, thus complicating the overview and reducing the inclination to change."

"As the investment management IT system is at the heart of their business processes, it may be a daunting thought to replace the core, believing it puts their business at risk. However, on the contrary, we believe that doing nothing will in fact put the business at a greater risk."

For a variety of reasons, a legacy system may continue to be used, sometimes well past its vendor-supported lifetime, resulting in support and maintenance challenges, comments Morris. "It may be that the system still provides for the users' needs, even though newer technology or more efficient methods of performing a task are now available. However, the decision to keep an old system may be influenced by economic reasons such as return on investment challenges or vendor lock-in, the inherent challenges of change management, or a variety of other reasons other than functionality."

"One of the biggest issues we come across in almost every securities lending project is the problematic setup of data to accommodate trades that legacy front- and back-office systems cannot properly handle. This can lead to a lot of complexity when new systems are incorporated into the mix; they often end up being tailored in some way to suit the historical data formatting requirements of the legacy system," he adds.

If the stars align, and managers decide that their current systems are not up to scratch—there still remains the question of whether to build in-house or to go in search of off-the-shelf systems.

"Interest is increasing in commercial packages, even if some banks decide to continue with in-house/bespoke solutions," says Patel. "Banks and brokers are facing a more frugal reality, which demands low key investment. Off-the-shelf solutions are generally a lower investment proposition than in-house builds as the implementation and overall run costs are not as high as with bespoke solutions. So what tends to happen is that clients are compromising on functionality, leading to users changing the way they work in order to fit in with a package solution. We see this outlook continuing over the short-to-medium term as business drivers are set on gaining operational efficiencies but at a low cost."

Whether to go in-house or shop around depends on what the client requirement is, says Morris. "Many choose vendor systems to try and limit their risk and reduce capital expenditure, although badly run implementations can often lead to unexpectedly high costs. Our experience in implementing securities lending vendor systems has enabled us to help clients overcome problems that they face."

"Over the years MX Consulting has completed large- and small-scale proprietary builds for clients where vendors do not offer the appropriate solution. We have built operational platforms, collateral and cash management solutions, order management and most recently a regulatory compliance system, so there is certainly a market for bespoke securities lending development of this kind."

"Increasingly, we see a clear tendency that financial institutions are looking for off-the-shelf, standard systems," says Holse. "They require a platform they can confidently rely on, and allow them to focus on their core business, which typically does not include IT system development and maintenance. Ideally, firms are looking for highly automated systems with 'one version of their truth' where data is concerned."

Still, he comments, investment managers who choose a best-of-breed, patchwork strategy—meaning they use different systems in different parts of the organisation—will still have to spend time on building interfaces and connecting many different systems.

"Building your own systems means that you do not share the cost of changes with anybody. In a standard system, regulatory changes are done once by the vendor and shared with all users which is significantly more cost effective."

Following on from this, Holse argues that since IT development and maintenance is not their core business, the quality of a firm's proprietary system cannot necessarily meet the same demands as a system that is built by someone with deep industry knowledge and invests solely in system development.

"The challenge for those with homemade systems is the ever-increasing flow of new demands, financial instruments and regulatory requirements. These require a solution that can easily adapt and comply with the requirements and provide reporting to the relevant authorities, clients and management. Following on the heels of the financial crisis, we are also experiencing that many investment managers are now preparing for growth and need a platform that can scale and grow with them as their business develops."

With all of the technological changes in the industry, an argument can be made that it is easier for a new operation to offer a high quality service to customers, rather than an established business, which has to change many of its legacy systems and practices.

"[The old adage], 'build it and they will come', does not necessarily work," argues Patel. "So entirely new businesses may have a good/modern solution/platform for services, but that is no guarantee of success. Greenfield implementations are easier for those who have no historical baggage, but the existing business practices and platforms embody a significant level of organisational learning that still needs to be provided by a new platform."

Integration, he adds, is a tricky part of new or replacement platforms, when a large number of existing systems require interfaces to a new platform. "If those interfaces exist in a legacy platform, a partial replacement may be very difficult. A large-scale change that could render many of the interfaces unnecessary (by consolidating many existing applications into few, providing native integration within and between modules in a suite) is a daunting task."

Here's the specifics

Whether industry standards are influencing system design, and if they are universal enough, remains a vital question in technology systems.

"It is well documented that having well defined and adopted industry standards leads to increased business agility and improved integration, both of which have a direct impact on the bottom line," says Patel. "For example, the standardisation of messaging plays an important role due to the complexity of communications needed to effectively operate in the market."

Taking this messaging example further to focus on the securities lending industry, Patel comments that it is clear that the industry does not have a common set of standards in order to integrate systems. As a result, there are many disparate services available in the market with no common data interface.

"If we were to look at the cash equity market, it has a widely adopted and mature FIX protocol which allows for easier and faster integration between disparate systems. When our industry agrees on a set of industry wide standards, there will ultimately be an overall improvement in system design and integration."

Another challenge to the industry is static data—particularly in corporate actions.

"Static data is a challenge almost everywhere," says Patel. "Few banks or brokers have managed to build a comprehensive but flexible static data management system. While a 'master copy' of key data may be maintained in a centrally managed data solution, integrating it with numerous legacy systems is a large investment."

He adds that corporate actions in particular have been an area of concern for his clients. With nearly a million corporate actions every year, the industry is said to suffer losses of approximately $1 billion due to inefficiencies in the processing chain.

"The events can arrive in varied formats, with issuers using different terms to describe the same events. These messages pass through several intermediaries, including agents and custodians, before reaching the investor. A lack of industry standards for formatting these messages means that at various stages, data may be communicated in differing formats and technologies, even such as fax, thus adding to their processing time."

"This makes the information flow risky and error-prone, opening companies to the possibility of huge losses and reputational damage. Furthermore, processing of these announcements can be costly with the added in-house data validation coupled with inefficient processing in legacy systems."

Sell versus buy

The buy side's attitude to investing in IT com-

pared to that of the sell side has historically been markedly different.

"We have spent many years working with asset management companies and it was certainly true in the more distant past that the buy side had not invested in their securities lending businesses to the same extent as the sell side," says Morris.

But he argues that in the last 10 years or so, the attitude became much more proactive as the executive boards of asset managers began to realise that a good securities lending desk could be very profitable, offsetting to some degree their diminishing fund charges.

SimCorp deals entirely with the players on the buy side of the financial industry. Kolse comments that a recent survey conducted by SimCorp StrategyLab confirmed that buy-side institutions operating on a legacy system need to invest more compared to those with a modern, state-of-the-art solution, simply to keep up with the pace of change in the market.

"They are not investing to modernise their solution, but solely to keep up. We have also seen in a recent poll conducted among 70 executives from 50 buy-side firms in North America that technology investments or upgrades within the next two years are planned for new or updated derivatives systems in order to comply with the regulatory changes in the OTC derivatives processing space. Similarly, many plan to invest in building an investment book of record to centralise position keeping across all assets. The need to invest in IT is necessary to keep up with the ever-changing industry."

Though it can be a bitter pill to swallow, the consequence of regulatory concern on IT system investment is big, and may mean considerable changes for securities lending systems in the future.

"As we all are aware, regulators perse are for now the main drivers of change," states Morris. "In the shorter term, the scale of investment in securities lending will be governed by the impact of these new regulations—there is no choice. In the longer term the impact of regulations on profitability will decide how much money is invested into securities lending businesses. Allocations of budget within financial services is now sharply focused on whether businesses can meet ROI criteria."

"Although it is the case that the overall return from securities lending has reduced, most businesses are still making good profits, reinvestment into any businesses that makes a good return is always important to maintain competitive advantage," he adds. "Businesses in the main are focusing on collateral, triparty and regulatory reporting and these are areas where we have been able to help our clients."

"We believe that investing in IT is important for any investment manager," says Kolse. "The pace of change will continue unabated and we will have to be prepared for further changes: in regulation, the introduction of new financial instruments, entry into new markets and increasing transaction volumes.

"Having the right system in place is thus paramount; it will not only provide the foundation of the investment manager's business, more importantly it will create a competitive advantage."

"The dangers of underinvestment are evident; according to a recent study on buy-side IT spend by leading industry analyst Celent, buy-side firms use less than 20 percent of their IT spend on new software and development—and over 80 percent is used simply to maintain and operate current applications. In conclusion, underinvestment is unsustainable and may put firms at risk as the industry evolves and competitive pressures grow." **SLT**

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A trusted mentor

Executives at the collateral and clearing practitioners firms, CCP Consulting and Oesa Partners, talk to SLT about optimisation and management of collateral—as well as the importance of choosing the right advisor for your firm

GEORGINA LAVERS REPORTS

What does CCP Consulting do, and how is it unique in the marketplace?

Simon Furey: There is a proliferation of organisations offering advice or solutions for collateral optimisation in the marketplace at the moment, a variety of accountants, technology vendors, outsourcers and service administrators.

Our differentiator is the firm's leadership, each have more than 20 years' experience of making collateral, clearing, legal or risk, with a real network built from achieving 'real life' operational readiness. This experience means we have the relationships and know all the main players in the market, while remaining independent. We have a proficient track record of picking out technology platforms, services, building operating models, and negotiating agreement terms for clients that are bespoke where necessary to meet the client's needs.

From a post-trade viewpoint, we give clients a unique, end-to-end solution to suit their needs and budgets, rather than a one-size-fits-all agenda. There is change crashing into the buy side at the moment from all the new regulation of both sides of the pond and the time horizons for complying are tight, but our independence and expertise means that we can be of value and assist clients in a timely manner.

Kate Wormald: As Simon [Furey] has mentioned, a unique facet of CCP Consulting is our specific industry experience. I have my own business, Oesa Partners, and have joined forces with CCP to provide a joined up solution to collateral optimisation.

I feel my own career speaks volumes to this domain expertise. I haven't come out of a large law firm, but after qualifying as a barrister, I went in-house at several large securities houses, including Salomon Brothers and Goldman Sachs. So I was at the coal face during the past two decades and had to address not just the legal and regulatory challenges as a senior sales and trading lawyer, but also how this is integral to a bank's operating and risk management procedures for good governance.

How have trends such as collateral optimisation affected your firm?

Paul Winter: There has been a big drive in the market to focus on collateral optimisation. The process begins upstream with the legal agreements and the terms that bind the transaction such as eligible collateral, haircuts and re-hypothecation. As well as these, firms must know what collateral they have at their disposal and it's cost of usage at their fingertips in order to deliver out to meet obligations in the most efficient and cost effective manner.

We help organisations re-organise and codify their inventory, to understand what's in their inventory of assets, and how to make best use of that. Firms also need to think about collateral transformation and cheapest-to-deliver assets. Our service involves taking all these parts and connecting them together. We are continually hearing across the industry how collateral management is moving from the back-end service to a front, almost revenue-generating, type of practice. We understand this cultural shift, its drivers and its realisation. It is systemic from the perspectives of legal, inventory, settlements, pricing, collateral, and static and reference data. These combine together as an intricate, highly convoluted problem.

This is further complicated as there is so much regulatory change at present, covering such a lot of areas in front, middle and back office. People don't know what to concentrate on first.

Do they wait for the European Market Infrastructure Regulation (EMIR) to land before making changes to client clearing—or do they need a new collateral platform? We help people to understand their application architecture and their desires, and help them to create a roadmap that doesn't destabilise their operation too much, and assists them in a quick delivery.

Wormald: One of the substantial issues here is keeping expectations of what sell-side counterparties can do on your behalf in achievable terms. If people assessing the changes for the buy side are merely looking at the letter of the regulation or at fixing the need to centrally clear, they are not necessarily thinking of change from an operational perspective and how that needs to join up with what their counterparts can do.

Without people with some experience of supporting trading desks and risk management functions, it is far more difficult to understand how the clearing works from front to back end and the limitations to what can be achieved and therefore from the legal perspective how the legal agreements should be structured and tailored for the buy side.

Our understanding of the relevant areas and how they are integral to each other means we have good relationships with the banks, as we can see the problems they are facing as well because these regulatory changes affect everyone, and the solutions are very expensive too. So we couple this knowledge with our ability to see things from the buy side's viewpoint, and so assist in protecting their interest in a pragmatic and practical way that works for everybody.

Speaking of regulation, how are rulings in EMIR and MiFID II, among others, affecting business?

Winter: We are seeing a marked interest and uptake across the business, as people want to get across the line with regulation. There are a lot of unanswered questions, but the deeper you read into the various rules and regulations, the more you understand them. We're seeing activity on the corporate side, which is also worried about EMIR, and this has proved to us that it's not just the buy and sell sides, it is also the pension funds, corporates and insurance companies that are concerned.

Furey: Anyone who is trading at significant levels of OTCs will be touched by EMIR. For the buy side, there are three pieces of legislation coming in at present that are in the technical standards stage. These are EMIR, the Alternative Investment Fund Managers Directive (AIFMD), and MiFID (Markets in Financial Instruments Directive) II. To know where to start you need to consider them all, and in particular, where they overlap.

Kate [Wormald] has closely examined the technical standards for each of these regulations to see the combined impact of EMIR. For example, one of the big uncertainties for the buy side is around their classification. Some buy-side firms that are 'EU persons' believe they will be NFC (non-financial counterparties) when they almost certainly won't be. In turn, this has led them to believe there are exemptions on hedging, etc, that will keep them from mandatory clearing and other change, when as FC (financial counterparties) these just don't apply.

For the corporate side, most can achieve NFC status, but they are still a little unsure of how this is going to affect them and it's more about proving that classification and reporting. As the technical standards are firming up, people are still unsure of where they lie. All the while, time is running out.

Wormald: The breadth of new regulation and the fact that it is being pushed through by politicians at an alarming pace, without the usual time allocated for consultation, has put a lot of strain on firms. For example, EMIR only came in last July, and the technical standards were agreed upon on 23 February this year. Yet the implementation could begin this summer for some obligations.

Similarly, another regulation that is being implemented right now is AIFMD and that has many hedge funds concerned at the short length of time for them to comply. However, like many of the EU directives at present, it has cast its net much wider than just alternatives. A small godsend to the directive is that if you're a non-EEA (European economic area) fund, there is a longer transitioning period, especially in relation to marketing across Europe. Also, the UK FSA (now the Financial Conduct Authority) has been doing a good job by consulting in advance of the technical standards and is offering a year's transitioning period. So it has been a little ahead of the game where they could be.

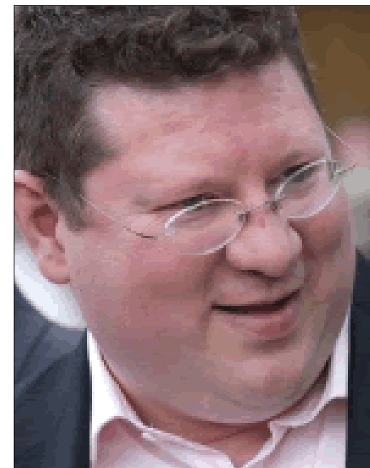
Other than regulation, what are some other key issues around CCPs?

Wormald: One issue for central clearing is the counterparty exposure as most alternative funds or corporates will not want to be members of a CCP. So many of the buy-side participants will have to clear via a bank counterpart or their prime broker. There are many things to consider when choosing which bank to use, like the counterpart's credit rating, which CCP the banks can clear with, whether full segregation or omnibus segregation of the collateral is available, and so forth.

It is important therefore to remember that the clearing model is more closely aligned to futures and options exchange-traded products, as opposed to the bilateral International Swaps and Derivatives Association (ISDA) model. So the banks are able to call margin in the same way as they do for the exchange products. This is on a far more discretionary basis and in their favour as it is not limited to what they post onto the clearer. Whereas, under ISDA and a CSA, if you negotiate the terms correctly, the discretion is more limited and haircuts and independent amounts are pre-agreed and notice periods for changing these terms are available.

The other issue that people seem to have lost sight of is the fact that the CCP model was meant to reduce systemic risk, whereby a third party held the collateral for the two trading counterparts. But if the buy side is clearing through the banks, the excess collateral is held at the banks and not the CCP, so the counterparty risk is really with the bank and so this is not risk mitigation as intended. Consequently, people are now looking at how to hold the excess collateral and where to put it in order to reduce the counterparty risk, and we believe there will be another wave of change as products and systems are designed to address this issue. So we are actively looking at solutions for our clients to ensure the their collateral is not only optimised, but safe. **SLT**

Paul Winter
Director, collateral management
CCP Consulting



Simon Furey
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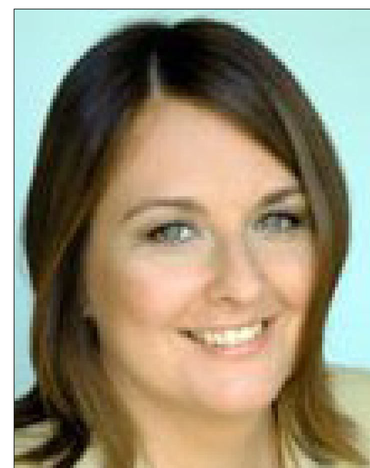

Kate Wormald
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Lombard Risk 4SIGHT FINANCIAL SOFTWARE SUNGARD® SIX SECURITIES SERVICES

Optimise time

SLT's experts assess the integration of collateral activities with front office trading, and debate whether optimisation is a blessing or a curse

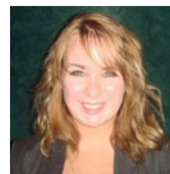
James Hills
Collateral business matter expert
Lombard Risk

Martin Seagroatt
Head of global marketing
4sight Financial Software

Olivier de Schaetzen
Director and head of global market products
Euroclear

Robert Almanas
Managing director for international services
SIX Securities Services

Ed Hellaby
Product manager
SunGard's Apex Collateral



Georgina Lavers
Deputy editor
Securities Lending Times

How has the changing dynamic between the front and the back office shaped the future of any collateral dealings?

Olivier de Schaetzen: The asset types to be used as collateral to cover an exposure are becoming an integral part of trading/liquidity management decisions. In fact, this information now needs to be known before trading occurs, as it directly influences the economics of the trade. Having a complete understanding of what pools of collateral are available and how they can be mobilised requires strong cooperation across front and back offices. Moreover, the collateral manager is now directly connected to the front office and liquidity management teams. Market dynamics have repositioned the collateral manager at the crossroad of many critical activities for financial firms, ranging from securities financing, foreign exchange, derivatives and the core of the core—liquidity management.

Martin Seagroatt: In the past, collateral management was largely a middle- and back-office function. Now, there is greater integration of these activities with front office trading.

This is largely due to two factors:

- Traders are now more aware of risk, as well as the pricing of risk. The risk function is therefore becoming more closely integrated with front office trading decisions.
- Collateral funding costs are now a more important part of profit and loss (P&L) and traders need to factor this into trading decisions. For securities finance, this also includes the risk-weighted assets (RWA) and balance sheet usage of a trade and the cost of regulatory capital versus the P&L a trade generates.

As firms adapt to this new business model, a unified front-to-back office solution for collateral management that provides trading and inventory monitoring, collateral cost control, exposure management, central counterparty (CCP) margining and settlement offers real advantages. It makes it easier to communicate key information on risk exposures, collateral usage costs and liquidity management between traders, risk, operations and senior management.

Robert Almanas: Prior to the 2007-8 crisis, many institutions viewed collateral management as a back-office function. Changing attitudes to risk management combined with greater collateral demands in current and upcoming regulation have repositioned collateral management as a front office and even board-level concern at some institutions. The front office can no longer trade without a good understanding of collateral management practices.

James Hills: Collateral management was once a purely back-office function, an end of 'trade life cycle' process. Margin collateral provisions were rarely part of trading strategy and this blurred the lines of the true cost of trading.

The regulatory environment has also changed substantially since the financial crises, creating the emergence of mandated central clearing and more stringent collateral requirements both for cleared and un-cleared trades.

The requirement to use higher quality collateral is causing a squeeze on liquidity as a finite pool of higher grade collateral is sourced by market participants. Add to this collateral segregation and in some cases the inability to re-hypothecate, and it's clear to see the increasing costs in the collateral management process, creating pressure on firms to manage their asset inventories with far greater efficiency and control.

As a result, we are now seeing a much larger firm wide involvement in the collateral management process. In many institutions, the collateral management function has been moved to the front office, as trading desks try to control the increased cost of collateral and look to optimise their asset inventories.

Collateral provision is now being considered as part of trading strategy, a pre-trade activity and the costs are being attributed to the trades that cause the exposures, making the process far more transparent.

Ed Hellaby: In times of small margins, the cost of collateral has become an increasingly important component in the profitability of a trade. For example, Nomura recently published a paper explaining the collateral currency convexity problem and this affects trade valuations. In a move to mimimise collateral costs, front-office collateral traders and back-office collateral analysts are having to work closer together today than they have in the past and collateral selection has moved from a back-office process to a front-office asset allocation decision with a P&L impact. This can be seen in the rise in prominence of collateral trading desks that provide a vantage point across the firm's trading and inventory silos, allowing them to best calculate how collateral could be allocated to minimise cost to the firm.

Many are also taking this one step further by initiating a collateral optimisation program. By working with traders to codify rules around the selection of collateral that take into consideration attributes such as cost, eligibility, haircuts and limits, firms can leverage optimisation platforms to provide greater scale and savings.

Do you think there are dangers to collateral optimisation, and how can any fears be assuaged?

Almanas: Collateral optimisation can present fresh risks. Some institutions and CCPs believe that it is acceptable to repackage existing portfolios to create fresh collateral pools. It is this sort of behaviour that was responsible for the sub-prime mortgage crisis in the US in 2008. The industry must endeavour not to repeat the sins of the past.

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and easy-to-value. Collateral that does not adhere to these values, or principles if you will, should not be acceptable to CCPs or any other financial institutions.

Hellaby: Collateral optimisation is one of the most talked about topics within the industry at present. In a recent collateral management survey undertaken by SunGard, optimisation was identified as of high to medium importance by more than 90 percent of respondents, yet more than 75 percent did not have a process embedded within their organisation.

> When a firm is under extreme liquidity stress and receiving calls for increased margin, a collateral management solution can help it to meet these margin calls with acceptable collateral quickly

One of the key dangers we see in the market is that the collateral optimisation space is completely new for many participants and not well understood. The skill sets and technologies that go into building a collateral optimisation solution are vastly different to a traditional collateral operations workflow tool. Given the results from an optimisation solution are only as good as the inputs, it's imperative an organisation has a clearly defined optimisation objective from the outset and implement to a solution that will grow in sophistication as the benefits of cost-based, numerical optimisation algortithms become more evident. We see more engagement with vendors in the optimisation space than ever before in the collateral world as firms look for help to guide them through the new landscape.

Seagroatt: Optimisation is just a more efficient way for firms to manage the supply and demand for collateral. It's hard to see any hidden dangers from it. You can only pledge out what your counterparty will accept as eligible collateral.

In fact, there is an argument that it could actually help with liquidity management and make firms safer. Take the recent default of MF Global. The report into the bankruptcy identified an inability to meet margin calls on its repo to maturity funding for its peripheral euro sovereign bond portfolio with appropriate collateral as a key factor in its collapse.

The report indicated that the lack of an automated collateral management solution meant that MF Global's operations staff were trying to manually allocate acceptable collateral at a time when the operations department was already under pressure and the firm's liquidity was strained.

I am not suggesting that better collateral management would have prevented MF Global from defaulting. It wasn't the sole factor in the firm's downfall. However, when a firm is under extreme liquidity stress and receiving calls for increased margin, a collateral management solution can help it to meet these margin calls with acceptable collateral quickly.

An optimisation solution can also help the distressed firm to pledge the 'cheapest to deliver' or more accurately, the 'hardest to deliver' assets its counterparties will accept as collateral. This means it allocates available assets across its range of counterparts in a more efficient way and this could help to free up valuable liquidity when it is needed most.

Optimisation may also have benefits to the financial system as a whole. It can allocate scarce collateral more efficiently and potentially help to reduce some of the systemic impact of collateral shortages.

However, the optimisation process is by its very nature imperfect. Do not listen to anyone who tells you they can perfectly optimise a collateral portfolio across all counterparties—this is not possible.

There are many factors involved in collateral optimisation. The process must consider many types of transaction costs, the practicalities of substitution/reallocation, complex counterparty eligibility criteria and haircuts across the portfolio, and constantly changing market dynamics. This makes it hard to gain a truly perfect allocation of assets in real time.

As with most activities, there is an 80/20 rule in play. The added effort required to achieve the hardest to obtain cost savings is often not worth the diminishing returns. Optimisation is very much based on the best practical allocation of collateral, rather than the best possible allocation. It is also very specific to each firm, its risk profile and business strategy. For this reason, 4sight typically builds new customised optimisation algorithms to meet the needs of each individual client.

One area where there are dangers is in collateral management itself. Collateral management is after all, a method of mitigating risk. Collateral management technology solutions can provide a very valuable tool to help manage counterparty credit risk. They can automate manual processes, provide clearer views of firm wide exposure, and help to manage liquidity and risk in a crisis.

However, they will always be a tool to support a common sense, human decision on counterparty risk management. Factors such as liquidity risk and wrong way risk in collateral acceptance will most likely always require careful thought. The technology is there to help collateral managers do their jobs, rather than doing it for them, although it does help to reduce some of the manual effort and operational headaches involved in the collateral management process such as substitutions.

de Schaetzen: There are benefits to gain from increasing collateral management appreciation and expertise at financial firms. Only those with such expertise will be able to fully exploit new business opportunities, as making securities work harder as collateral is becoming a primary business objective across the financial industry. In a world of low margins and strict capital requirement rules, astute collateral management expertise is a necessary factor to remain competitive.

Taking a smart approach to collateral optimisation is an obligation rather than a danger. Posting the right collateral at the right place at the right time, together with a continuous requisition of collateral allocations, are due to become the pillars of future collateral management requirements. We can see firms tracking changes in collateral eligibility rules in the future, where central counterparties begin to map their rules with available pools of collateral. To achieve collateral optimisation in this changing environment, firms will be looking for efficient and affordable outsourcing arrangements, such as triparty collateral management services, to gain the required expertise without having to make the required investment.

Hills: Collateral optimisation is a logical response for firms as regulatory pressures increase and collateral costs are managed more efficiently. Of course, the word optimisation is very subjective and what is optimal for one firm may be completely different to that of another. A further consideration is that firms will always attempt to deliver to each other collateral that is optimal from their point of view, which may eventually force a renegotiation of legacy legal documentation.

Collateral optimisation is also likely to increase operational costs. There is also a risk that optimisation could be taken too far in that there is a relationship between collateral optimisation and the intervals at which an optimisation process is performed. The optimal asset allocation will change throughout any given period or trading day and it will be important for firms to assess the trade-off between collateral optimisation and the operational cost of doing so.

A strong single platform technology solution with firm-wide inventory management and the capability to control costs will help address the optimal balance of collateral optimisation and operational costs whilst satisfying regulatory requirements.

How can firms have a clear integrated view of their collateral requirements and asset pools across their global enterprise?

de Schaetzen: For most firms, obtaining a holistic view of all their available collateral resources is a major challenge, both across business lines and geographically. Connecting pools of potential collateral remains a key challenge when they are fragmented, as is the case today. Improving the mobility of collateral across locations where cash trading occurs is an area where providers such as Euroclear can add value. Working with partners such as BNP Paribas, Citi and Standard Chartered, we provide securities inventory management services that source and mobilise collateral assets from wherever they are held and moved to wherever they need to be provided.

Bridging the gap between idle domestic market holdings and the need for collateral to access international financing is now enabling clients to make their collateral assets work harder. Having smart inventory management capabilities makes for dynamic collateral management opportunities across collateral pools in various holding locations. Our intent is to make this possible worldwide. Our recent announcement of a memorandum of understanding with DTCC in the US to provide a joint collateral service is a key part of this strategy.

Hills: Collateral management is becoming a firm-wide effort, involving front office, treasury, credit risk, oversight and regulatory control, and collateral management teams. All areas now have to accept some responsibility and accountability for the proper design, governance and execution of the collateral management programme. There needs to be greater technological integration across the collateral management process, as well as a more integrated approach to the current product silos that exist within institutions.

A changing culture from product silos to cross-product margining can be achieved with enhanced technology infrastructures and systems that can provide a holistic view of collateral management across multiple business lines via a single platform technology. A consolidated firm-wide inventory management detailing all firm assets will facilitate collateral optimisation to meet stringent regulatory requirements while minimising the increasing cost of collateral. Lombard Risk's single platform technology COLLINE delivers the capability to achieve these goals.

Seagroatt: Clients come to us asking for optimisation but in most cases, they don't yet have integrated view of inventory across assets and business lines so this is something we often help with. Gaining a clear view of exposures and available inventory across business lines is a key step in optimising collateral. It probably gives the most bang for its buck in terms of the time spent versus the return on investment that can be achieved.

A collateral management system that offers a consolidated view of inventory and exposures across securities lending, repo and derivatives trades is fundamental for optimisation to take place. It allows traders to see available collateral assets on a firm-wide basis and helps risk managers to view exposures at any level of the firm. It is possible to achieve many of the cost savings from collateral optimisation by making better use of internal inventory to meet margin calls. A clear picture of all available assets across the profit centre hierarchy is essential for this.

Hellaby: A raft of innovation in collateral management platforms over the past few years has allowed firms to collateralise requirements across business lines under one platform. The advantages of this are clear in providing consistency of operational control and a single customer view of exposures and collateral to allow centralised decision making and identification of optimisation strategies such as offsetting of swaps and futures exposures. In addition, forward looking vendors have placed centralised inventory management capabilities as the keystone of their solution offerings. This is a huge shift from where the market was three to five years ago, when institutions were frequently posting out cash collateral and operational collateral management tools became a commodity. With the change of focus under the new reg-

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ulatory environment, collateral asset allocation and optimisation has become the driving force behind innovation and investment. Having an enterprise-wide view of inventory and requirements is also a pre-requisite for any institution wishing to undertake a collateral optimsation programme

Almanas: Put simply, firms must virtualise collateral pools. Rather than diluting what constitutes acceptable collateral, we must look to effectively mobilise what collateral exists. To achieve this, the whole chain has to work, allowing the creation of a virtual collateral pool across markets to eliminate the inefficiencies inherent in having to transfer securities across systems. It is therefore crucial that collateral can be valued across multiple time zones, systems, and currencies—a fundamental shift in the current collateral infrastructure.

How worried are you about the "global collateral shortfall"?

Hellaby: There is clearly a lot of uncertainty in the market around the level of impact of regulatory reform. On one hand, the recent annual report from the Financial Stability Oversight Council played down the impact, citing the fact that there has been an increase in sovereign debt issuance and broadening of collateral eligibility, taking the estimated amount of non-cash eligible collateral in the market to a figure in the region of $74 trillion. Given estimated collateral requirements of $3.5 trillion, this would lead to a collateral utilisation rate of less than 5 percent. However, this relies on the full $74 trillion of eligible collateral being mobilised in the market.

In addition the pro-cyclical nature of collateral means that in times of market stress collateral requirements will increase in conjunction with contraction in the amount of eligible collateral within the market. This uncertainty means firms cannot afford to ignore the potential challenges that lie ahead. Collateral management solution providers quickly identified the challenge their clients were facing and have moved quickly to introduce innovative solution offerings such as collateral optimisation and centralised, cross-asset collateral management platforms.

Hills: There is a risk we have exchanged counterparty risk for liquidity risk. The regulatory safeguards, including segregated accounts, initial margin and mandated collateral requirements implemented since the financial crisis may indeed have the unintended consequence of a collateral shortfall with increasing demand for high quality collateral, which will in turn increase costs and reduce market liquidity. This will increase the requirement for firms optimise their asset inventories, with strong process and technological infrastructures to support this. It is certainly something that is high on our clients' list of priorities. From a vendor point of view, it gives us the opportunity to develop market leading solutions in a single platform technology, providing the capability for firms meet and overcome these challenges and more effectively manage a potential global collateral shortfall.

Almanas: Upcoming regulation—in particular, the US Dodd-Frank Act, Basel III and the European Market Infrastructure Regulation (EMIR)—is forcing institutions to lock down much more collateral, probably to the tune of trillions of dollars. These demands are coming at a time when banks are cutting back on lending. The days of abundant collateral and liquidity that the financial markets have historically enjoyed may be coming to an end, so a global collateral shortfall is a very real possibility. In fact, in an upcoming collateral management study that we conducted, 53 percent of 60 financial institutions believe there will be a shortfall by 2015.

The trouble is that if there is to be a collateral shortfall, nobody has a clear understanding of how severe the shortfall might be. Estimates range from a few billion to several trillions of dollars. All financial institutions are having difficulty in responding against this backdrop of uncertainty.

While reduced liquidity caused by a collateral shortfall would prevent the smooth functioning of the markets, it is imperative that regulators do not dilute the definition of what constitutes acceptable collateral. The acceptance of low-quality collateral will only sow the seeds of the next crisis.

de Schaetzen: Pressure on finding eligible collateral will inevitably increase. While it is difficult to estimate the overall size of potential collateral requirements, any firm active in the capital markets is aware that they are likely to face collateral management challenges to ensure that all available resources are used efficiently in order to maximise business opportunities. New collateral requirements will also inevitably have an impact on many business models, which may lead some firms to re-evaluate some of their activities and potentially migrate some activities from one segment to another, for example, futures as an alternative to OTC derivatives.

Rather than anticipating collateral chaos, or a collateral shortfall or collateral cliff, I foresee the market adapting to the new regulatory and collateral realities. The only predictable outcome we can make is that the market will work differently and that firms that do not adapt to the new realities will struggle to survive. I am also optimistic that the new realities will create a more resilient market landscape.

Seagroatt: I'm more worried than I was, due to the effects of the proposed European Financial Transaction Tax (FTT) on securities lending and repo volumes. Hopefully, regulators will offer some sort of exemption, because as a high volume, low margin business, securities finance could really be hit hard. This would have the knock-on effect of reducing collateral velocity and killing market liquidity when it's most needed due to the added strain on collateral needs from CCP margining.

The days of abundant collateral and liquidity that the financial markets have historically enjoyed may be coming to an end, so a global collateral shortfall is a very real possibility

On the other hand, it's looking likely that regulators are happy to allow CCPs to accept a broader range of collateral (corporate bonds, etc), as long as haircuts are set appropriately to account for the added liquidity risk of these assets. This could reduce some of impact on collateral needs.

Regardless of the severity of shortages, the cost of collateral will most likely increase over the next few years due to the changing supply/demand dynamics. We therefore expect that there will be significant demand for services such as collateral optimisation and collateral transformation/upgrade trades. The cost savings from optimisation will also increase over time as collateral becomes more expensive.

What has the impact of derivatives pricing been on collateral?

Hills: Differences in derivative pricing models have historically caused collateral margin disputes, however, initiatives within dispute management and portfolio reconciliation have gone some way to addressing these issues. There are also punitive actions for outstanding dis-

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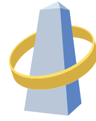

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putes such as the Basel III reform forcing banks to apply longer margining periods as a basis for determining regulatory capital, which should further encourage institutions to solve pricing differences more quickly.

> With firms likely to attribute collateral costs to trading strategies more in the future, collateral is likely to become a decision making factor in the pricing of derivative trades

The post-financial crises regulatory framework, with mandated initial margin requirements, is also likely to bring this subject into greater focus, but the problem could be exacerbated by the fact that a standardised methodology for calculating initial margin has yet to be defined.

With firms likely to attribute collateral costs to trading strategies more in the future, collateral is likely to become a decision making factor in the pricing of derivative trades, considering costs such as the venue at which trades are cleared and the type of collateral required.

de Schaetzen: Collateral resources, and especially those that are CCP-eligible, are due to rise in demand. Many studies have evaluated the impacts of recent regulatory changes, such as those linked to the clearing of OTC derivatives, and have reported some astronomical numbers on the need for CCP-eligible collateral. So far, demand does not appear to have had a significant impact on the availability and pricing of 'renting' CCP-eligible collateral assets. But it is still early days and work is still being done to unlock pools of CCP-eligible collateral in order to prevent collateral shortages.

Innovative solutions, such as Euroclear's recently launched GCAccess product that aims to increase CCP-eligible collateral liquidity, has been warmly welcomed by the market. The product provides general collateral on a non-cash collateral basis, enabling firms to upgrade their collateral to avoid CCP-eligibility barriers.

Seagroatt: Derivatives pricing is beginning to incorporate collateral funding costs through the lifecycle of the trade through calculations such as funding value adjustment (FVA).

There is also a growing consideration of credit value adjustment (CVA) charges on uncollateralised exposures and the inclusion of counterparty default risk in derivatives pricing due to Basel III. These calculations involve factors such as collateralisation, potential future exposure simulations and collateral netting. The terms of a collateral agreement such as thresholds and minimum transfer amounts can also have an effect on CVA/DVA and FVA so this is leading to a closer consideration of these aspects of the collateral management process.
All of this means that information flows on collateral requirements, usage costs and exposures are becoming more important for both risk analytics solutions, derivatives pricing tools and regulatory compliance.

From a securities lending and repo point of view, collateral also affects trade pricing and P&L more than in the past. This ranges from collateral funding costs, to factors such as Basel II/III RWA calculations and a trade's balance sheet consumption.

Lending/repo desks need to consider these factors to gain a true P&L figure, as they dictate the cost of capital for a trade. A good example of this is in collateral upgrade/transformation trades for CCP clearing.

A collateral upgrade offered by a clearing broker/FCM to clear a derivative trade with a CCP involves a repo trade to upgrade the collateral. This trade has an impact on balance sheet and consumes regulatory capital.

If the trader can see at the point of trade what the cost of this regulatory capital is, then it is possible to gain a clearer idea of how the firm should price the upgrade trade for the derivatives client, or whether it is even profitable to offer it in the first place. So we're moving to a world where firms need to think more about both collateral optimisation and capital optimisation when making trading decisions.

Hellaby: FVA, along with cost allocation, has become an integral part of new, more efficient margin calculations, whereby we are now seeing the cost of collateral being factored into deal pricing from the outset. We have seen from several industry papers how matching collateral terms to the trade economics can affect P&L and many firms are trying to improve their processes to accommodate these factors. Adoption of OIS discounting for collateral requirement calculations helps, but it also provides operational challenges for many and has increased the level of disputes. Identifying, pre-deal, the best counterparty or clearing venue to perform a trade is now a key part of the trading decision, and indeed choice of counterparty or location will affect the deal price.

In addition, with the increased capital charges and collateral requirements for bilateral trading, firms will need to consider the cost of funding capital and collateral that any new deal will attract.

What are the hurdles to making a collateral management system more efficient?

Hellaby: It is widely accepted within the industry that firms must look to centralise their collateral management processing across business silos in order to realise process efficiencies. However, for many there is not the risk appetite to rip out four or five legacy systems and replace them with one new cross platform solution, or indeed the organisation has not yet aligned its business units to make such a drastic shift. The answer lies with a modular-based collateral platform that will allow an organisation to initially replace one existing component, then over a period of time migrate existing business lines onto the platform.

Hills: An efficient collateral management system is a technically challenging undertaking with the raft of regulatory and market initiatives since the financial crises. A capable and efficient collateral management solution should now ideally be a single platform technology that supports multiple products on a firm wide/global basis with a centralised and consolidated operational workflow providing a holistic view of the collateral management process. It should be extremely configurable as the market trend moves from a silo-based collateral management approach to cross product margining.

The technology solution should support exception-based processing to manage the high volumes of margin calls in today's financial markets and provide seamless connectivity to internal and external technology platforms, enabling further exception based processes such as electronic messaging and automated reconciliation.

It should also be a modular solution that can support different business lines and fit into any technology infrastructure according to firm requirements. Furthermore, it be a scalable and

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sophisticated technology, with functional flexibility to accommodate future business, market and regulatory initiatives and requirements.

Seagroatt: The main hurdle is having a consolidated inventory view in real-time. The complexity of the optimisation process, the number of variables involved and the bespoke nature of optimisation can also complicate the process. As discussed above, this is always going to be imperfect and will involve diminishing returns from the investment in time and data processing involved. There is also a trade off between the complexity of optimisation calculations and the time taken to perform them, as traders typically need to make decisions quickly.

However, there are many ways that collateral management solutions are going to evolve in the coming years and at 4sight we are working on ways to improve the process. This includes:

- More STP and automation
- More analysis of the cheapest place to execute a trade—this can be very complex and based on factors such as initial margin requirements, collateral eligibility schedules and regulatory capital costs
- More sophisticated collateral portfolio substitution
- What if scenario analysis on collateral pools
- More efficient trade pricing and the impact of collateral on P&L, regulatory capital usage costs and balance sheet usage
- Greater integration with the risk function.

Concepts such as 'cheapest to fund' are becoming more common in collateral management and awareness is increasing

Optimisation is very much in its infancy and will continue to evolve in response to market and regulatory change. Financial firms are under a lot of pressure to adapt to a very demanding operating environment. There is also heavy competition between technology vendors to enhance optimisation techniques and processes.

This will drive improvements for the foreseeable future and ensure that the collateral optimisation race continues at its current pace.

de Schaetzen: They are many opportunities to make collateral management more efficient. The main one is linked to unlocking siloed or fragmented collateral pools. Fragmentation covers a variety of dimensions, including geographic and business line fragmentation. Everyone can see the benefits of managing a single pool of assets to meet collateral needs across businesses and geographical locations, but this is a real challenge.

Concepts such as 'cheapest to fund' are becoming more common in collateral management and awareness is increasing within various business lines that collateral costs have a direct impact on the bottom line. Geographic fragmentation of collateral remains a reality for many reasons, including regulations that force entities operating in individual markets to hold enough resources to remain self-sufficient.

To improve the situation, infrastructure service providers are making significant investments to improve collateral mobility from where the collateral is held to where it is needed. Global collateral mobility management is not to be underestimated, as we believe it will become an integral and critical part of the collateral optimisation process. It will also require special skills to deal with increasingly complex issues, such as interoperability.

Almanas: In our experience, cost is seldom the biggest hurdle for an institution in making a collateral management system more efficient. Many firms see the benefits of adopting a triparty collateral management system as opposed to a bilateral one. Under a triparty system, a third-party collateral management provider administers exposures and collateralises them using assets of the same value.

This provides access to a central pool of collateral from market participants all over the world. Triparty systems reduce risk, are easy to use and can provide clear views of requirements and collateral pools provided that they are capable of responding to requests to segregate margin.

Nevertheless, bringing in a third-party collateral management provider is no easy task. Many institutions suffer from IT interfacing problems or find that the on-boarding process can take too long. However, those institutions that do invest time and money in upgrading their collateral management systems will soon reap the benefits. **SLT**

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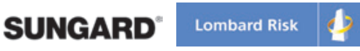

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Web 2.0 roundup

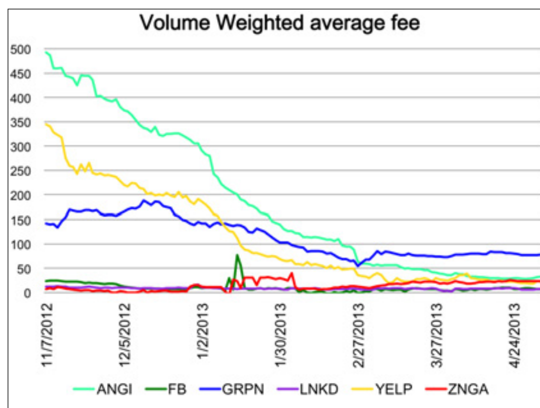
DataLend's Chris Benedict looks at the good, the bad and the downright awful

"Those who do not learn from history are doomed to repeat it" is a well-worn phrase that can be applied to most aspects of life, including the stock market. The internet bubble burst of 2001 had barely finished crushing the 401(k)s of hapless investors before the term 'Web 2.0' was coined. Web 2.0 is a broad, nebulous buzzword to describe the current generation of web-based services allowing users to collaborate, share and store information on open platforms through rich, dynamic user interfaces via an internet browser. But which Web 2.0 companies look to be the next Amazon superstar or Pets.com debacle in the securities lending market today?

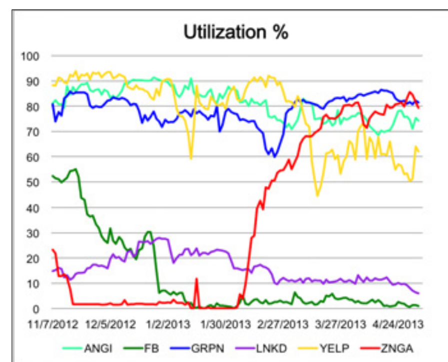
A plethora of Web 2.0 IPOs have launched over the past few years, most notably the disastrous debut of overhyped Facebook, which practically crashed the NASDAQ market the day it began trading in May 2012. The resulting backlash provided fodder for market pundits globally, a few late night comedians and plenty of ammunition for short sellers. In the days that followed the IPO, the market price tanked well below its price of $38 per share down to a low of $17.55, while the stock traded at a hot 3000 basis points (bps) fee to borrow shares with a 65 percent utilisation in the securities lending market. More recently, the stock has stabilised, trading in the $27 per share range with a very low 1 percent utilisation and a general collateral level of 9 bps to borrow shares. But Facebook may not be out of the woods yet with investors looking closely at its mobile advertising revenue as a primary growth driver for the company.

Shares of online game developer Zynga have certainly worsened after its $10 IPO started trading in December 2011. In the months that followed, the stock entered an ugly downward spiral, hitting a low of $2.09 per share in November of last year while the fees to borrow the stock reached nearly 400 bps. Shares have rebounded a bit since then, trading around $3.50, but they are still highly utilised at 77 percent while commanding a relatively cool 40 bps fee in the securities lending market. While the company reported a surprise profit in late April, it issued disappointing revenue targets, stalling a short-lived rally in shares. Its long awaited announcement of entering the online gambling market in the UK recently did little to boost the stock. At present, the stock continues to falter as short interest remains high at 6.2 percent and competition in the internet and mobile gaming world remains fierce.

Online coupon seller Groupon was another Web 2.0 company investors loved to hate in 2012. The stock was the biggest internet IPO since Google, raising $700 million with a higher than expected IPO price of $20 per share. But as with other overhyped internet companies of the past, the buzz wore off quickly and the stock collapsed in 2012 to a $2.60 low in November 2012. During this period, the stock reached a high of 382 bps to borrow shares and a utilisation of 82 percent. The stock has rebounded to more than $7 per share and fees have cooled to a current 94 bps while still maintaining that very high 82 percent utilisation. But with competition from Google, Amazon and other online retailers, and an easily copied business model, Groupon's long-term survival prospects look dim.



Consumer review aggregators Angie's List and Yelp floated their IPOs in 2011 and 2012 respectively and shared very similar patterns in their stock prices: a nice pop above their IPO prices followed by an immediate downturn when the short sellers stepped in. Angie's List traded as hot at 9000 bps with a 81 percent utilisation in late December 2011 before hitting a $8.94 low in the market, while Yelp shared similar statistics with a blazing 9500 bps fee and a 95 percent utilisation before trading at its lows of $14.10 per share in June of 2012. Both stocks have recovered since then: Angie's List stock price has bounced back to $24 per share and currently trades with a high 74.7 percent utilisation but a fairly low 39 bps fee and a 10.45 percent short interest. Yelp looks to be on more solid ground at $31 per share, a low 17 bps fee, a utilisation of 50 percent and a 5 percent short interest. Currently, neither stock is anywhere near as hot as they were in the securities lending market last year.



A clear winner in the Web 2.0 roundup has been LinkedIn, bucking the trend of overhyped IPOs gradually fizzling out. Its $45 per share IPO price popped to trade at an impressive $94 in May of 2011. But many were skeptical at first, paying anywhere from 1500 to 3500 bps to borrow the stock; utilisation remained in the 75 to 95 percent range during the first few months of trading until upbeat analyst reports and consistently strong numbers from a business that relied on advertising for only 30 percent of its revenue reassured investors. Since then, fees to borrow shares and utilisation have both dropped enormously: the stock has had a strong run, approaching $200 per share with a 7 bps fee and a low 12 percent utilisation. Despite a security breach in June of 2012 and an earnings misstep in early May, investor confidence remains strong in this name and LinkedIn looks well positioned for the long haul.

Web 2.0 hasn't been nearly the disaster many of us remember from the Web 1.0 days of 'this time it's different' exuberance into the 2001 internet bubble carnage. Many Web 2.0 companies are actually profitable and have a real business model, a rarity for 'dot coms' in 1999. The mobile revolution also offers substantial growth opportunities. Some Web 2.0 companies wield massive power and influence: just look at what a hacked Twitter account did to the US equities market for five minutes of trading on 23 April. The securities lending market has changed from a very bearish view of these companies in their early days of trading into a more neutral stance. But even with the seemingly unstoppable rally in equities, some of these companies still trade near their 52-week lows with high utilisations. Overall, the market seems to be saying that these companies are more fairly valued in the marketplace … for now.

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Shippers are hipper

Short sellers are targeting shipping over freight, says Will Duff Gordon, research director at Markit Securities Finance

Shipping firms are finally gaining control of their destiny. Cutting capacity, forming alliances and sensible rates have seen share prices settle. Yet short sellers continue to target stocks.

Freight firms on the other hand have had a positive start to the year as trade worldwide has picked up. Shares of the three largest freight firms have performed in line with the market despite large fixed assets bases.

Shipping firms were caught short by the coolness of the global economies over the past few years. Entering the low growth zone with masses of excess capacity and a reluctance to take drastic action, their share prices have been sinking for some time.

The Dow Jones Global Shipping Index is the basis of the Guggenheim Shipping ETP (SEA), and the price fell 44 percent in 2011 and a similar amount in 2010.

Most shorted shipping firms

In aggregate, short interest has come down across the board with investors taking profits after the price falls in 2010/11. Of the European listed firms, Kuehne & Nagel sees rising short interest to 10 percent of the free float due to its European focus and inefficiency. No other European firm has double digit short interest, however.

Sell-side analysts are upgrading their recommendations most energetically for WILH WILHELMSEN, the Norwegian shipper.

In China, spare capacity, the economic malaise in Europe and the increasing internalisation of consumption means that a variety of firms have double-digit short interest such as China Shipping and Hanjin.

Of the US-listed firms, there are some sizeable recent increases in short interest in Genco and Eagle Bulk showing great pessimism in their near-term future.

Short interest in the bell weather giant AP Moller Maersk is non-existent, but the proportion of the company owned by institutions that lend has been slowly increasing this past year. Some clearly feel that the cycle will rebound in their favour.

Dividend outlook

AP Moller Maersk would be one of the bigger dividend payers (with their pay date just gone) and Markit Dividend predicts a yield of 2.96 percent in the next financial year.

The table below shows firms increasing their dividends by the most amount, with COSCO Pacific looking attractive from a yield perspective, according to Markit's FY13 projection.

Biggest Projected FY13 Dividend Increase - Marine

Stock Name	Markit FY13 DPS (Gross)	Currency	Action	FY13 DPS YoY Change	Markit 12mth Yield
Pacific Basin Shipping Limited	0.01	USD	Increased	55.29%	1.77%
Wan Hai Lines	0.4	TWD	Increased	50.46%	-
* Kawasaki Kisen Kaisha Limited	3.5	JPY	Increased	40.00%	1.55%
COSCO Pacific Limited	0.059	USD	Increased	17.97%	3.77%
Orient Overseas (International) Limited	0.13	USD	Increased	9.80%	2.19%
Mermaid Marine	0.12	AUD	Increased	9.09%	3.26%

Yields are based on dividends going ex during 14 May 2013 - 14 May 2014

C.H. Robinson Worldwide Inc

Freight and logistics firms

Scale is a key component required to succeed in the freight and shipping world. The three large global firms; Fedex (FDX), UPS (USP) and DHL owner Deutsche Post (DWP) have a combined market cap that is 40 percent greater than the remaining 158 firms in the airfreight and logistics Global Industry Classification Standard sector.

This comes as no surprise as the business has large barriers to entry for potential companies looking to offer a competitively priced, fully integrated end-to-end global product.

To this extent, both Fedex and UPS have above average fixed asset turnover ratios, according to Markit Data Analytics & Research. In comparison, more nimble asset light companies have outperformed the market year-to-date by an average of 1.5 percent a month.

The share prices of Fedex, UPS and HLD have performed well this year, but this is in line with the overall market as the companies look to ride the wave of rising global trade. The increasing importance of web retailing also looks set to play into these company's hands.

This has not all been plain sailing, however, with FedEx missing its profit guidance in its latest quarterly earnings as customers elected for lower priced, slower shipping options. Volumes were up, however, in line with rising exports.

Large firms see bullish sentiment

On the short interest side, few freight firms see much in the way of short interest, with nine of the top 10 firms by market cap having below average short interest. This lack of appetite to from short sellers also coincides with the fact that all but one firm in the top 10 shippers are expected to raise dividends next year.

Of the large three firms, DWP sees the largest proportion of its shares out on loan with short sellers currently borrowing 1.9 percent of the firm's shares. This rise coincides with continuing economic weakness in the company's domestic European market, which is responsible for over half of its business.

Beyond the top three

Looking beyond the top three, CH Robinson sees the most short interest among the group with a market par of 2.8 percent of the firm's shares out on loan. This comes in line with weakness in the US trucking business, which CH Robinson is reliant on. **SLT**

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ISLA's 22nd Annual International Securities Lending Conference

Date: 18-20 June 2013
Location: Prague
www.isla.co.uk

The International Securities Lending Association is delighted to announce that the 22nd Annual International Securities Lending Conference will be returning to the beautiful city of Prague on 18-20 June 2013.

European Beneficial Owners' Securities Lending Conference

Date: 19-20 September 2013
Location: London
www.imn.org

IMN is proud to announce that its 18th Annual European Beneficial Owners' Securities Lending Conference will take place September 19-20, 2013, in London, UK.

Securities Lending: 2014 Outlook

Date: 21 Nov 2013
Location: London
www.securitieslendingtimes.com

SLT and Citi invite beneficial owners and consultants to a seminar looking at navigating securities lending in exceptional times.

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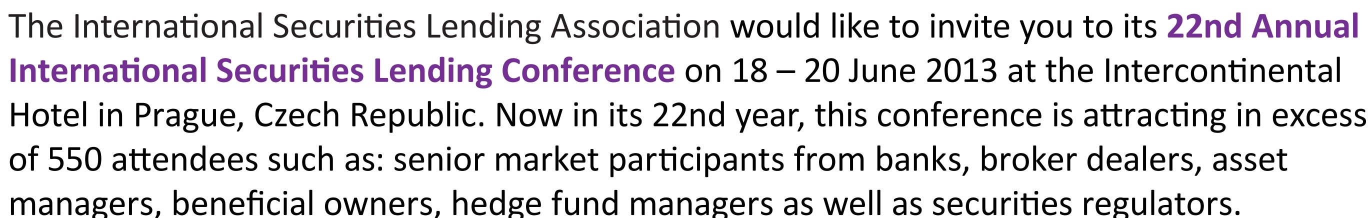

The International Securities Lending Association would like to invite you to its **22nd Annual International Securities Lending Conference** on 18 – 20 June 2013 at the Intercontinental Hotel in Prague, Czech Republic. Now in its 22nd year, this conference is attracting in excess of 550 attendees such as: senior market participants from banks, broker dealers, asset managers, beneficial owners, hedge fund managers as well as securities regulators.

SPECIAL KEYNOTE ADDRESSES

WEDNESDAY 19 JUNE

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Chair, ***European Securities and Markets Authority***

THURSDAY 20 JUNE

Andrew Neil
Publisher, writer and broadcaster

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Industry appointments

Russian financial institution BCS Financial Group has recruited **Dipak Rajani** and **Timur Salikov** to its sales and research teams. Rajani joins as director of international prime brokerage sales while Salikov comes on board as a senior oil and gas analyst.

Prior to this role, Rajani spent five years as head of prime brokerage execution sales at BNP Paribas, where he was responsible for its global execution services division.

He was also head of UK, Benelux and Iberia for the institutional senior sales team at E*TRADE Securities, and has held various positions at SunGard, BNY Mellon and Dresdner Kleinwort Benson Securities. He will work alongside Tim Bevan to develop its customer base.

Salikov joins from Morgan Stanley where he worked for four years, most recently as co-head of the bank's CEEMEA oil and gas research team in London. Prior to this, he worked in the investment banking division at Deutsche Bank.

In April, BCS Prime Brokerage appointed **John Barker** and **Edward Golosov** to its board to join existing executive directors Rizwan Kayani and Vitaliy Shelikhovskiy.

Golosov was one of the founding partners of BCS Financial Group, and rejoined as an executive director after five years with Barclays Capital Fund Solutions, where he was global head of structuring and origination.

ConceptONE, a provider of data aggregation, risk management, reporting, and advisory solutions, has hired **Cary Goldstein** as managing director and head of business development.

Most recently, Goldstein was advising hedge fund clients on operations, technology, and regulatory and risk management as a director of Bank of America Merrill Lynch prime brokerage's hedge fund consulting team.

He has also served as the global head of IT for the principal strategies desk at Goldman Sachs, and as an associate director of business development for Newedge USA's prime brokerage group.

Consultancy firm Doran Jones has strengthened its prime brokerage offering with the addition of **Lou Lebedin** and **Gerard Muldoon**. The pair join as partners.

The firm, which was founded in 2010, will help prime brokerage clients with strategy, technology and regulations.

Lebedin left J.P. Morgan in May 2012 after serving as head global head of prime brokerage. Muldoon left his position as global head of operations technology at Citigroup in June 2012.

Their arrival at Doran Jones follows that of Duncan Rawls, who most recently served as managing director and global head of prime brokerage/equity finance technology at J.P. Morgan.

Doran Jones will also add two members to its board of advisors.

Deutsche Asset Management's former chief administrative officer **John Nolan** will chair the board. **Susan Peters**, who previously served as chief executive at eSecLending, will join him.

Roger Edwards has left mutual life and pensions company Royal London after the firm announced changes in management structure.

Edwards was the managing director of UK protection brands Bright Grey and Scottish Provident.

Edwards will continue in his current role and will support the transition to the new structure of the intermediary division, whereby the firm's pensions and UK protection businesses are being centralised. He had been at the company for 12 years.

Rob Ferguson has been elected president of the Canadian Securities Lending Association.

Ferguson, senior vice president in the capital markets team and head of global securities lending at CIBC Mellon, takes over from Reeve Serman, who recently left RBC Investor Services.

He was confirmed as president of the association during its annual conference on 8 May.

UBS confirmed that **Daniel Sofianos** has left the bank, where he was the Asia Pacific head of stock borrowing and lending.

UBS moved Sofianos from London to Hong Kong to build up UBS's stock loan inventory and then distribute to local hedge funds and global hedge funds operating in Asia.

Sofianos, who had been based in Asia for UBS, worked on hedge fund sales in London for the Swiss bank before moving back to Hong Kong. He had been at the bank for 19 years.

BNP Paribas Securities Services has appointed **Lance Wargo** as head of securities lending in North America, a newly created position based in New York.

Wargo will be responsible for product development and operational strategy for the global custodian's securities lending solution in North America, a strategy aimed at attracting institutional beneficial owners.

Wargo and his team will report to Christina Feicht, head of market and financing services in North America, and John Arnesen, global head of securities lending, based in London.

Wargo joins the bank from Wells Fargo & Company in Short Hills, New Jersey, where he spent 13 years, most recently as head of trading and investments for securities lending.

This appointment signifies the impending launch of the bank's US securities lending services with a specific focus on agency lending.

Wargo is joined by a team of senior hires including **Michael Saunders**, head of trading and investments; **Richard Chen**, investment and credit analysis; **Frank Souder**, investment and risk control; **Amardeep Singh**, IT technical leader, **Mauricio Padilla**, IT business analysis, and **Travis Bartlett**, operations specialist.

Most of the team comes to BNP Paribas from Wells Fargo—Singh, who also worked at Wells Fargo, spent the nine months prior to coming to BNP Paribas at Deutsche Bank.

Northern Trust has boosted its staff in Hong Kong to include **Bradley Blackwell**, who is the new sales and relationship management for securities lending clients in APAC.

Prior to this role, Bradley was a securities lending relationship manager in our Chicago office and responsible for all North American large corporate relationships.

Northern Trust opened its Hong Kong office in 1995 and moved to larger quarters on the 19th floor of Two Pacific Place, 88 Queensway in 2012 to accommodate the growing staff. **SLT**

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