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Cantor Fitzgerald creates equity securities lending team

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Cantor Fitzgerald has created a new equity securities lending team within the Cantor Prime Services Group, with the hiring of Allen Wolkow and Janah Angelou, who will co-manage the effort. Wolkow and Angelou were co-founders of Hedge Source LLC, a securities lending consulting firm for hedge funds.

"Adding these experienced professionals deepens our relationships with our current client base and expands the universe of clients we can attract," stated Noel Kimmel, senior managing director and global head of prime services at Cantor Fitzgerald.

"Allen and Janah have a proven track record and have both built and managed securities lending businesses during their respective careers that were widely recognised within the industry for outstanding execution and exceptional client service. Their experience and breadth of relationships in this marketplace, combined with Cantor's financial strength, are tremendous assets as we continue to expand the capabilities we offer Prime Services' clients."

"We are thrilled to join the Cantor Prime Services team," Wolkow and Angelou said in a joint statement. "This is an exciting time in the hedge fund marketplace with great opportunities to deliver value added services for our clients. The equity securities lending team enhances Cantor Prime Services' efforts to create a seamless platform and single point of contact for hedge funds. We look forward to helping Prime Services build an even greater market franchise by continuously addressing our clients' needs and developing services that meet their requirements."

The hiring comes on the heels of the announcement last month that both the management team of PCS Dunbar Securities and the majority of its clients had joined Cantor Fitzgerald's Prime Services Group. This transaction added a number of talented professionals to the Prime Services' team, expanded the client roster, and expanded the buy side trading off-dollar capabilities.

NEWSINBRIEF

Greywolf Execution selects SunGard

Greywolf Execution Partners has selected SunGard's Valdi Order Management System (OMS), Valdi Liquidity Solutions, MarketMap and SunGard Global Network (SGN) for its institutional trading business.

Greywolf chose SunGard to help simplify and manage its trade lifecycle across multiple platforms, creating trading and operational efficiencies.

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Monte Titoli launches triparty collateral management service

Monte Titoli is developing a new triparty collateral management service, called X-COM, to support the financing and investment strategies of market operators.

Within the new service, Monte Titoli will play the role of neutral triparty agent, allowing customers to manage their assets more efficiently and in real time. X-COM, dedicated to treasury departments and back offices, will provide a flexible set of tools for more effective risk and liquidity management and for the optimisation in the use of collateral. Moreover, customers will benefit from automatic administration of collateral requests and a real time allocation, substitution and restitution of securities.

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Greywolf Execution selects SunGard
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SunGard's global trading solutions will help Greywolf enter new markets and trade new asset classes more quickly and easily and find new revenue opportunities. SunGard will also help Greywolf increase speed of execution with a more streamlined trade lifecycle. Greywolf Execution Partnershas also signed up for the Valdi Shares Reward Programme, which provides non-fiduciary sell-side firms with the ability to earn credits toward technology fees and reduce their overall technology costs when executing or clearing trades through SunGard's Valdi Liquidity Solutions.

Christopher Martin, president of Greywolf Execution Partners, Inc, said, "Our goal is to provide our customers with a consultative approach to trading. We are able to do this because our firm has years of market experience and we are located on the floor of the NYSE. SunGard's Valdi and MarketMap solutions, and the SunGard Global Network will help us grow our business by helping us effectively manage and execute trades and broaden our reach into new asset classes and markets."

Raj Mahajan, president of SunGard's global trading business, said, "We provide a 360 degree approach to trading that creates economies of scale and cost savings for our customers. Our solutions assist our customers in growing their business by helping them expand into new markets, and to execute more volume through our competitive execution services. We also help our customers gain economies of scale by working with a single vendor and by participating in Valdi Shares Rewards."

Monte Titoli launches triparty collateral management service
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Paolo Cittadini, CEO of Monte Titoli said: "The new triparty service will offer our customers enhanced efficiency, safety and flexibility and is an example of Monti Titoli's commitment to providing creative new solutions for its clients.

"X-COM will significantly reduce our customers' administrative burden and provide back offices and treasuries with a dynamic new tool that will help them drive their businesses forward"

Kevin Milne, director of Post Trade, London Stock Exchange Group, said: "The introduction of the triparty service is the result of considerable investment by Monte Titoli in a programme of product innovation. Effective collateral management is vital to our customers and I am delighted to see the launch of this new service, which will actively support the essential business functions of our clients."

X-COM is due to go live this autumn, subject to regulatory approval.

The service will immediately, upon launch, align with the money market operations of the Bank of Italy. As a result a bank using Monte Titoli's triparty service will have its interaction with the Bank of Italy simplified, taking advantage of "re-use" facilities by transferring securities already received as collateral to the central bank for re-financing operations.

Finadium releases report on costs of collateral

Finadium has released a free white paper on the mechanics of who pays the cost of collateral for OTC derivatives trades in the US.

The paper analyses recent CFTC and FDIC hearings, Basel III rules on bank capital and the financial alternatives for OTC derivatives end-clients.

Although commercial end-clients appear to have won a victory by not having to post collateral for non-cleared trades, in fact costs will increase in the OTC derivatives market for commercial hedgers and speculators alike.

For end-clients to minimise the impact to their balance sheets, now is the right time to evaluate cash and non-cash collateral needs including investigating the utility of collateral conversion trades.

ASIC changes securities lending rules

The Australian Securities and Investment Commission (ASIC) has released new regulatory guidance and relief aimed at achieving better disclosure by parties that are engaging in securities lending of substantial holdings in listed entities.

The guidance is contained in Regulatory Guide 222 Substantial holding disclosure: securities lending and prime broking (RG 222) and the relief is contained in Class Order [CO 11/272].

ASIC has also released Report 235 Response to submissions on CP 107: Securities lending and substantial holding disclosure (REP 235), which summarises consultations with industry leading to the new regulatory guidance.

Under the new guidance, ASIC sets out its expectations as to how:

- parties involved in securities lending (including securities lenders and borrowers) will disclose substantial holdings in listed entities (interest of five per cent or more)
- prime brokers – who may have on-going borrowing agreements with their clients – will disclose substantial holdings

Further, ASIC has set out its expectations of the content of substantial holding notices that parties engaged in securities lending will have to provide, and relief that ASIC has granted in [CO 11/272] to simplify the content of those notices and better align timing of disclosures to changes in control over securities.

SEC approves OCC rule change

The US Securities and Exchange Commission has approved a rule change clarifying the net capital treatment of certain stock loan transactions processed through OCC, confirming the central counterparty clearing benefits OCC brings to this marketplace.

SEC rules governing securities lending require broker-dealers to take a capital charge associated with collateral posted in certain stock borrow transactions. In December, OCC filed the rule change to clarify the regulatory treatment under Rule 15c3-1 of collateral and margin posted by clearing members for transactions through their participation in one of OCC's stock loan programmes. The rule change means firms would not be required to take a deduction from net capital for stock loan transactions while participating in OCC's Stock Loan/Hedge or Market Loan programmes as the collateral related to the loaned stock is secured and offset in OCC's margin system.

This rule change is part of OCC's continuing effort to enhance capital efficiency for its clearing members. When added to the security afforded by OCC's risk management, it provides a greater incentive for firms to conduct the securities lending transactions in a cleared environment.

dealReporter launches new dividend outlook service

dealReporter has launched its enhanced dividend outlook service that provides estimations on future dividends of CAC 40, DAX and FTSE 100 companies. It breaks down balance sheet pressures and offers intelligence on dividend timing.

The argumentative dividend outlook service breaks news and special events that could impact dividend payments. The dedicated dividend outlook analysts split down the capital structure of a company using dividend history, borrowing structure, dividend policy and the latest news flow to build their estimations.

dealReporter's dividend outlooks are backed up with analysis including discounted cash flow modelling, payout trends, option pricing, and dividend yield sensitivity. The dividend outlook service also includes a "Special Dividend Payment Rating" on the companies in our universe to help analyse how likely a company is to make a one-off capital return.

The analytical service is also backed up with breaking news from our team of reporters on corporate events that could cause a company to change its dividend payments or policy.

"By the end of March, 32 per cent of companies within dealReporter's coverage had increased dividends by an average of 22 per cent," dealReporter head of research, Alexei Komarov said. "dealReporter's dividend outlook service anticipates a further 65 per cent of companies will follow this trend increasing their payouts by 34 per cent in 2012."

The dealReporter dividend outlook service will provide dividend history and the likelihood of excessive cash distributions vs M&A activity. It will cover cash-rich/cash-poor companies highlighted for dividend changes and real-time analysis of companies' liquidity and capital structure.

Lucinda Guthrie, dealReporter editor, EMEA said: "dealReporter's dividend service will help provide visibility on forthcoming changes to a company's dividend payments and policy."

OneChicago changes fee structure

OneChicago is modifying its trading fee structure in a move that it says will illustrate the superior financing rates and significant cost savings market participants experience while carrying their equity exposure via security futures. As interest rates rise, the value proposition will be accentuated.

The details of the new fee structure are:

OneChicago fees will be divided into two parts – an execution fee, charged to the executing firm and a daily carry fee, charged to the carrying firm.

OneChicago's execution fee is $20.00 per $1 million (2/10th of a basis point) dollar executed notional value.

OneChicago's carry fee is $1.00 per $1 million (1/100th of a basis point) dollar notional value per day. For fee purposes, OneChicago will cap the settlement price value at $120.00.

Futures on narrow based indexes will remain on a per contract basis at execution with no carry fees. The new fee level for futures on narrow based indexes will be $1.00 per side per contract vs. the current $.50 per side.

"We are always looking for ways to highlight the cost savings and superior financing that security futures provide to our members," said David Downey, CEO of OneChicago. "Using security futures as a financing tool with our new fee rate structure will offer direct comparison to current financing costs for customers. The implementation of this fee structure also sets a new industry standard for trading listed derivatives."

The change will be effective on May 1, 2011.

Pershing Prime Services forms new strategic alliance

Pershing has formed a strategic alliance with Roubini Global Economics. The agreement will provide Pershing's hedge fund, broker-dealer and registered investment advisor customers with exclusive research and analysis on trends and developments shaping the global economy. The first proprietary report, available exclusively through Pershing, is titled States and Sovereigns: Eurozone and US State Debt Woes.

Roubini Global Economics, led by economist Nouriel Roubini, will produce semi-annual research reports and host conference calls that explore macroeconomic trends and developments. Roubini Global Economics will also participate in a series of events hosted by Pershing Prime Services, BNY Mellon Alternative Investment Services and BNY Mellon Global Markets that are designed to help alternative fund managers, advisers and investment professionals navigate the economic landscape.

The inaugural report, *States and Sovereigns: Eurozone and US State Debt Woes*, offers in-depth analysis of key questions surrounding the relative risks associated with Eurozone sovereign debt and US state debt, including, how US state finances are weathering the crisis given their diminished revenue and looming liabilities for pensions and other public employee benefits, and how high is the anticipated risk of debt default among nations on the Eurozone periphery in the next two years.

A discussion on the credit fundamentals of US municipal debt and Eurozone sovereign debt will be included during the April event, which features Arnab Das, managing director of Market Research and Strategy at Roubini Global Economics as the keynote speaker. Das will explore the financial and regulatory environment surrounding the alternative funds industry.

"As global economic shifts present new portfolio challenges and opportunities for fund managers, demand for timely, macroeconomic analysis is on the rise," said Craig Messinger, managing director of Pershing Prime Services. "Our relationship with Roubini Global Economics, a respected leader in economic research, underscores our commitment to providing our customers with a wide range of thought leadership and industry resources."

The strategic alliance formed with Roubini Global Economics enhances Pershing's institutional research services, which includes a real-time repository of research reports and recommendations that encompass thousands of global securities and a diverse range of methodologies, geographies and sectors.

"Understanding macroeconomic influences and their implications is more important than ever to the investment decision making process," said Arnab Das. "The exclusive research developed for Pershing's customers will help a growing universe of portfolio managers and financial advisors capitalise on new trends shaping the global economy."

BANK OF ENGLAND

Bank of England reports on securities lending

The Bank of England has published the minutes from its recent market update for the securities lending industry.

In the repo markets, an increase in Euro Overnight Index Averae (EONIA) volatility in January was reported, although specific reasons remained unclear. The temporary spike in the ECB standing facility to £15.7 billion in February created some market uncertainty and led to increased volatility of specials. However, this was soon reported to have been a temporary phenomenon and specials volatility returned to normal levels.

Repo volumes had been strong with an increase in short-dated repo trades on one major electronic platform from £188 billion (in Nov 2010) to £205 billion. There continued to be significant interest in Spanish bonds cleared through the LCH, with demand particularly notable in terms from one month to one year.

The RONIA (repurchase overnight index average) project was in the final stages and completion was expected later this year.

An increase in volume for five-year term collateral upgrade trades had been seen and commented on by a number of dealers. These had generally been collateral upgrade trades in which non-government collateral was placed to insurance companies in return for government bonds under securities lending documentation.

The committee was given a paper with a presentation on the potential benefits to the securities lending market of central counterparty (CCP) clearing. The presentation drew upon a note that was prepared for the committee. Committee members were invited to comment on whether CCP clearing could help mitigate key risks in securities lending markets; costs or risks to CCP clearing; whether there are barriers to adopting CCP clearing and how these barriers might be overcome; and whether there are other important risk factors which are not addressed by CCP clearing.

CCPs were thought to help facilitate more conservative and transparent margining practices, as hypothesised by the Bank of England note, but it was suggested that beneficial owners, for whom lending was an optional activity, could choose to withdraw from the market if lenders were margined. Committee members noted that whilst greater transparency would benefit the industry, transparency is already offered to some extent through data aggregators.

It was also noted that CCPs are potentially more capital efficient. A securities lending transaction via a CCP carries a zero per cent risk weight, compared to 20 per cent on a bilateral arrangement with a bank and 100 per cent with a pension fund.

It was thought important to consider whether a CCP clearing system would be able to process transactions on an anonymous platform or bilaterally, or a combination of the two. It was also noted that while the CCP's credit intermediation function allows participants to trade anonymously, such anonymity is not always preferable with securities lending. Furthermore, multiple CCPs would be needed to cover the range of markets in which securities lending activity takes place requiring contributions to multiple default funds by lenders.

Some SLRC members considered that adverse consequences arising from the implementation of CCPs in the near term could be a risk. Those members thought it better to allow them to find an appropriate place in the market in the medium – long term.

Committee members highlighted some potential concerns about the use of CCPs. One was that a CCP further lengthened the long chain of intermediaries involved in securities lending. This was a concern for beneficial owners who preferred to be "closer" to their securities.

The committee was updated on recent regulatory developments in which the FSA was involved. These included an update on the short-selling regulation, which is expected to be enacted between Easter and the summer; the European Market Infrastructure Regulation (EMIR) for clearing and reporting of OTC derivatives, also expected with similar timing; the MiFID and MAD legislative proposals, anticipated for May/June; EU developments on close-out netting; and the new UK resolution framework for investment banks.

The new UK resolution regime for investment banks – the Investment Bank Special Administration Regulations 2011 – will appoint an administrator to address the return of client assets and to work with markets to deal with failed trades.

The EU work on close-out netting, which forms part of a larger piece of work on resolution, aims to facilitate the resolution of a failing bank which has outstanding transactions subject to close-out netting contracts.

One option being considered is to allow resolution authorities, on an EU-wide basis, to impose a 24-48hr moratorium on the exercise of counterparties" close-out rights. Its rationale is mainly to provide authorities with additional time to consider the transfer of relevant contracts as part of a resolution measure.

Robeco opens desk in HK

Robeco Securities Lending has established a securities lending desk in Hong Kong, focused on securities lending and swaps in the Asian markets.

The company has appointed Zubair Nizami to run the desk. Nizami joins from Northern Trust, where he was a senior securities lending trader. He has six years experience, mainly focused on traditional securities lending.

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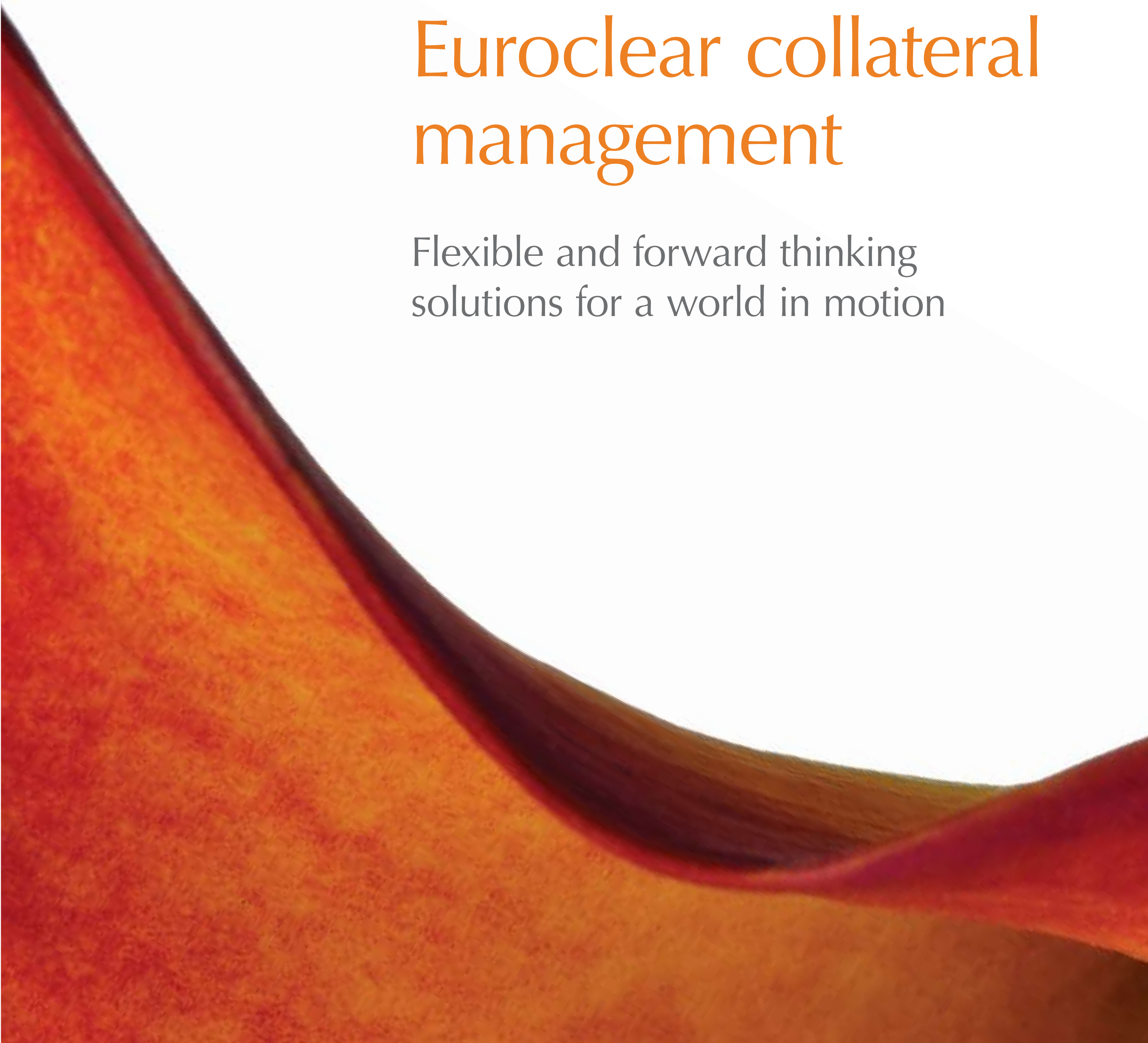


Olivier de Schaetzen	olivier.deschaetzen@euroclear.com	+32 2 326 2884
Leonardo Calcagno	leonardo.calcagno@euroclear.com	+32 2 326 2707

euroclear

Latin America

The big players are already gaining a foothold on the continent, and investors are excited about its potential

BEN WILKIE REPORTS

Along with Asia, Latin America is the big hope amongst the financial community for long term high growth, innovative product development and a range of opportunities. As one of the BRIC countries alongside Russia, India and China, Brazil is at the forefront, but there are a number of other territories where much is expected.

In the last ten years, several elements have come together to make Latin America a very exciting location for managers of and investors in hedge funds. These elements include a substantial and increasing population of wealthy and institutional investors, continuously improving managers and a flood of international investors looking for geographic diversification.

As the size of the market has grown, so too has its level of sophistication. Just as US, Asian and European investors have come to demand greater levels of operational and investment excellence, Latin American investors also now expect to receive the same standards. This includes institutional quality risk management, compliance, execution and a clear, repeatable and consistent investment methodology, among other things.

Wherever you go south of the US border, the international players can be found. Spanish banks have historically had a strong presence in most markets thanks to their colonial ties, and this has been strengthened with the mergers of Spanish and Portuguese providers. But the US banks are well represented, with Citi, J.P. Morgan and Northern Trust just three of the larger players. From Europe, HSBC has significant operations, as do Deutsche Bank and BNP Paribas. And there are a number of local providers who still claim to have the greatest market knowledge and the best service.

Mexico

Although there are some players with a more pessimistic view, the general feeling is that securities lending has done remarkably well during the downturn. “Within Mexico, we have seen the volumes of securities lending increasing about 25 per cent in the last two years,” says Patrick Avitabile, managing director and global securities finance head of equity trading at Citi’s Global Transaction Services in New York. “The short sells are increasing, and therefore, the market need for securities lending has grown. Offshore, we have witnessed an increase of roughly the same magnitude.

“The increase is mainly an offshoot of additional borrowers participating in the Mexican market. We now trade with in excess of a dozen counterparties, where that number was two-to-three two years prior.”

It’s international players that are driving the market, agrees fund consultant Enrique Sanchez. “We’re seeing an increased confidence in the underlying strength of the Mexican market,” he says. “Pretty much everything that could go wrong [in the economy] did go wrong in the last three years, yet the country remains on a firm footing. And that's a good advert for encouraging inward investment.

"We're also seeing more domestic funds involving themselves in lending securities. They have learned from their North American neighbours about the best ways to earn income while protecting themselves, and have an increased confidence in allowing their securities to be used. They still prefer the reassurance of a major international player to act on their behalf, however - at the moment, size really does matter when it comes to outsourcing these sorts of services."

The providers encompass the major international players in the region, in particular Santander, trading as Banco Santander Brazil, and J.P. Morgan. But there is also a strong domestic industry, with smaller firms servicing their local counterparts.

The securities most lent and borrowed are the major companies of Mexico, especially those that are offshoots of multinational firms - the Mexican offshoot of Wal-Mart, for example, is very popular, as are telecoms, oil and mineral stocks.

When it comes to collateral, the eligible resources are set out by the regulators. Federal bonds are the most popular form, although corporate bonds remain an option. Cash is not allowed, which creates significant differences from the US market, while if share are to be offered, they have to be in the most liquid and high-profile companies.

Perhaps uniquely amongst emerging economies, it's difficult to find someone prepared to criticise Mexico's regulatory or the regulators themselves. "We have never had a serious problem with the regulators here," says a representative of one of the major Spanish banks, who adds that this is not the case in other markets on the continent, particularly Brazil and Argentina.

"As securities lending has developed within Mexico, the authorities have taken the attitude that this instrument is good for the market and they have applied a light touch that others really should learn from. That's not to say that the market is unregulated - far from it - but that they do not make knee-jerk decisions that damage the market. They make sure they understand what is going on and what the impact of any new rules will be before they act. It's a breath of fresh air."

Brazil

Two firms dominate the securities lending market: the mining company Vale, and the oil business, Petrobras. Together, they make up almost 20 per cent of the market. Minerals and oil firms, along with banking, are the biggest securities, reflecting their positions within the investment markets.

"The Brazilian stock market is one of the fastest-growing markets in the developed world," says one player. "At the moment, the securities borrowers are interested in are limited because only a handful of companies dominate the financial landscape. But as the market grows and becomes more mature, and more companies become listed on Bovespa, this will filter down into the securities lending market because more people will be more comfortable working with more securities."

In terms of the participants in the securities lending market, mutual funds, both foreign and domestic dominate. "It's simple really, they've been in the [securities lending] market the longest, and they are most comfortable with the strategies involved," says fund consultant Eduardo Sanchez.

"They've also got the international reach, although many of the domestic ones stick to South America, so their lending decisions can be made on an international basis. Where we're not doing as well as we can is in getting pension funds involved - if they do any lending at all, they prefer cash collateral."

The providers encompass the major international players in the region, in particular Santander, trading as Banco Santander Brazil, and J.P. Morgan. But there is also a strong domestic industry, with smaller firms servicing their local counterparts.

"The major international investors prefer to use the international banks," says Sanchez. "And in Brazil, this is not a bad thing - the likes of Santander have been here for many decades and have a deep understanding of the market. Their local expertise is just as good as the domestic providers and they have the global breadth to help with wider strategies.

"However, I would like to highlight that the domestic firms are also very good value. They tend to service the smaller funds, and because their fees are sometimes lower - for the same quality of domestic service - they will always have a valued place in the market." **SLT**

Clearstream offers settlement access to Brazil

Clearstream is the first international central securities depository (ICSD) to include Brazil in its cross-border settlement network. The company now offers settlement and custody services for all asset classes denominated in Brazilian Real. The link, which went live at the start of the year, gives Clearstream customers the opportunity to develop post-trade solutions for the Brazilian market using Clearstream as their single point of access. Itaú Unibanco is Clearstream's local partner and will act as sub-custodian.

Mark Gem, member of the Executive Board and head of network management at Clearstream, said: "The settlement link to Brazil is key in light of our BRIC strategy and an important additional element to our presence in Brazil where we have already developed a collateral management solution for the local market.

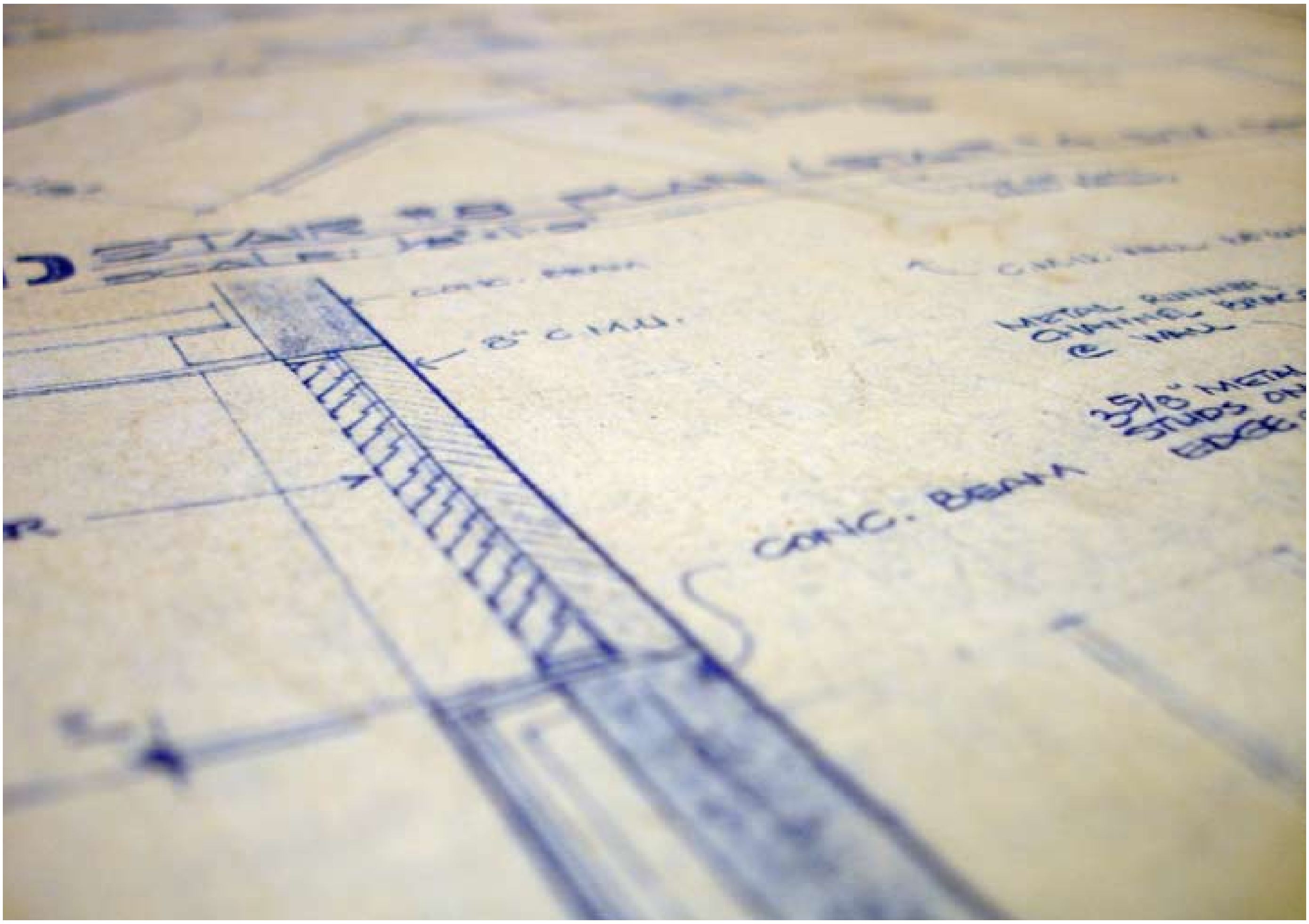
We are pleased to be the first European market infrastructure provider to launch a post-trade service for Brazil with Itaú Unibanco as local partner who best knows the requirements of this very large and segregated market."

Ricardo Lima Soares, director of the Capital Markets Solutions Group at Itaú Unibanco, said: "We are very pleased to support the leading European post-trade services provider Clearstream to further enhance its presence in Brazil. The new settlement link will allow the large international investor base to more easily access the Brazilian market. We believe that our in-depth knowledge of the Brazilian and South American financial markets assures that Clearstream clients will be provided the best possible service on site."

Clearstream has a long-standing presence in South America and in Brazil specifically. Its first steps in the region date back to the early 1990s.

Clearstream and Brazilian Central Securities Depository (CSD) CETIP launched an initiative in June 2010 to jointly develop and distribute triparty collateral management services across time zones. In the first phase, this service will be available for the Brazilian market. CETIP operates the leading marketplace for fixed income securities and over-the-counter (OTC) derivatives in Latin America.

Next issue:
Securities lending across Greece



Big interview

A year after the company came to market, HazelTree has big plans for the servicing of the hedge fund industry

BEN WILKIE REPORTS

SLT: HazelTree was formed after it was spun out from a hedge fund. Can you tell me a little about how the company was formed?

Casner: The reason behind the lift out was the technology the hedge fund had created – the fund had received several requests from other funds as to how to obtain that type of technology. At the same time, a private equity firm had a thesis that called for investment in next generation technology for hedge funds.

So the hedge fund and the private equity group together created HazelTree; that combination provided two advantages. First, we had the capital required for the commercialisation of the technology. Second, we created a "wall" between the foundation hedge fund and other potential clients who may have been concerned that their trading strategies and market views could be open to another fund - they now have the comfort that we are an independent technology company.

SLT: How has the technology evolved since the formation of HazelTree?

Casner: Any time a piece of technology is built for a single entity, it is built to cater to a specific set of business practices. And although hedge funds exist to manage significant holdings and generate large returns, they are usually small firms - mostly with staff of less than 100 - so they find their own best practices and focus on their own strategies.

Take for example the use of currency and managing FX risk. When hedge funds make bets internationally, some will take the sector view and the currency risk at the same time, while others don't want the FX risk at all or just want to take on the risk in selected communities. So when we lifted out our technology from our first fund, we needed the system to be able to work through multiple strategies and types of risk.

The business was formed in late 2009 and we launched it in April 2010. We spent a lot of time re-engineering the technology so it wouldn't just work for one hedge fund - we had to take in different types of investment strategies, counterparty relationships, different types of workflows and so on.

These tools are very powerful and very configurable and we have been able to launch funds on to the platform remarkably quickly.

SLT: Do the buyers need to take the whole system as an off the shelf product, or can they focus on the parts of it that they need?

Casner: There is a set of core tools that go across all clients and they are all about the data. It's either about bringing data in or organising data from multiple sources. Once the data is organised, clients have a choice. Some use the cash management services, while others are less interested in that but need help in securities financing, cash reconciliation, margin or collateral management. We can deliver the power of the technology to provide a treasury function as an outsourced service, whole or in any part desired. We also provide an API for them to customise reporting and integration with other purchased and internally developed applications, making it a very compelling solution.

SLT: Are you targeting particular types of client?

Casner: There are three types of hedge funds. The first and most numerous are the smaller funds with only one prime or introducing prime broker and we don't expect to attract that market. On the other side of the spectrum are the well established larger hedge funds with several billion in assets. Most of these firms have already recognised the value of treasury in their operations and have built solutions to help them. With those organisations we can help them go through their systems and define the value of their treasury operations - we can help them release the trapped value in their fund.

The key part of the market for us though is the mid market - those with over $100 million under management but less established than the largest funds in our industry. Once a fund gets over the $100 million mark, it has to deal with a whole set of new complexities, especially counterparty risk. This drives most funds to begin planning a multi-prime broker strategy. That is when the value of treasury accelerates very rapidly and that's when the fund is under the most scrutiny from institutional investors. We provide those outsourced treasury services to these funds.

Whether funds use HazelTree or another provider, they should be thinking about their treasury the minute they go into a multi prime environment. If they don't, treasury functions can have a lagging effect on the fund - it can create reporting and other data aggregation issues, which can drag down the performance.

SLT: How has the downturn affected the industry?

Casner: Everything changed two years ago. Every major fund was watching counterparty meltdowns and suddenly realised that counterparty risk would make everyone reassess their banking relationships. We're leading the effort to help sort out the complexities that arose from that transition, not just on the obvious risk issues but also how to leverage these new relationships to truly create performance gains.

SLT: How do you see the securities lending side of the market?

Casner: Securities lending is a fascinating business. It's one of the few opaque parts of the trading business left to talk about. Every other type of transaction, be it futures, options and so on, has become commoditised. It's impossible not to see how the last couple of years has affected transparency within the markets. But there is no generic market for hard to borrow stocks, and there is extremely limited access to market intelligence. And it's difficult to borrow a stock outside an existing counterparty relationship.

> It's difficult to borrow a stock outside an existing counterparty relationship

At the moment, prime brokers gain a significant portion of their revenue from these types of transactions. We recently helped a fund analyse their short book and found a seven-digit disparity between the market rate and the amount the broker was charging. The broker said it was inherent in the nature of the relationship and those rates funded other services it provided for free. Obviously our client was apoplectic - more because such transactions could have serious compliance repercussions that come from such an arrangement. So we see it as our job to help provide that transparency.

The securities lending market needs to become more open. A lot of people – AQS, Astec Analytics, Data Explorers and the like - are trying to do that, but until hedge funds and prime brokers get on board it's not going to happen. At the moment it's the type of business that seems to be carried out in smoke-filled back rooms without any transparency.

Our purpose is to help the fund by providing data transparency, especially in the rate discovery phase of securities financing.

SLT: You recently brought on a new member to your board of directors from a major prime broker. Does that appointment mean a closer relationship with that one broker?

Casner: It will mean a closer relationship with all prime brokerages. We are actively building our relationships with J.P. Morgan, Morgan Stanley, Credit Suisse, Deutsche Bank, Fidelity, UBS, Merlin and many others. The appointment sends a message to the community that we are a complementary service, not a competitor - our competitors may feel that they have to "beat up" the prime broker market to provide better treasury services, but we disagree. We're there to help hedge funds collaborate better with their brokers. It's about enabling better relationships, creating stronger hedge funds and increasing performance while mitigating risk.

SLT: Do you have plans for the fund administration side of the industry?

Casner: At the moment we are focusing on three growth areas. The first and foremost is our treasury services, which are already proving successful. The second is agency lending. We believe there is a role for a next-generation exchange and while we will have partnerships and not get directly involved ourselves, we will play an active role in evolving that part of the hedge fund industry.

We don't have any public plans for the fund administration sector, but I do feel that at the moment fund administration as a whole is broken and we can help enterprises get to the next stage.

Many hedge funds that self-administered came under huge pressure to outsource operations to third-party fund administrators. This meant the migration happened very quickly because funds had to shift the administration outside their walls to fund administrators who didn't understand their strategy, business practices and so on. This creates errors in processing that the hedge fund has to go back and correct.

We believe that a true next-generation fund administrator will have technology services that leverage the fund's expertise in creating efficient operations and data processing, while providing the proper, independent external audit and valuation services investors demand.

I believe the fund administration business is going to move in that direction over the next three years and I want us to be a part of that. **SLT**

Stepehn Casner
CEO
HazelTree Fund Services

Transatlantic discussion

SLT gathers four of the biggest names in the UK and US beneficial owner community to get their views on the securities lending market

The Panel

Harold Bimpong, head of securities finance - operations, Aviva Investors

John V. Johnson, CFA, senior investment officer, Wyoming Retirement Systems

Jerry May, securities lending / cash manager, Ohio Public Employees Retirement System

Gerard Moore, financial controller, Merseyside Pension Fund, commenting on the issues as related to UK local authority pension funds

SLT: What percentage of your portfolio is out on loan at any one time? Has this percentage changed in recent years?

John Johnson: Our average lendable assets have been roughly half of our AUM. Of those assets our range of utilisation has been between 30 - 40 per cent. over the last couple of years. It has remained relatively stable over the last few years. The utilisation rates have remained constant over the recent years.

Harold Bimpong: The extent to which portfolio assets are out on loan varies greatly depending on asset class and the underlying market. In equities, reduced leverage within the hedge fund/prime brokerage industry means that volumes are down significantly compared with three or four years ago, although recently we have seen encouraging signs of a pick-up in activity (albeit from a low base).

Having said that, demand for dividend-related strategies (eg, scrip trading, WHT arbitrage) has held up well throughout this period, with profitability if anything higher than a few years ago (although European tax harmonisation has restricted opportunities in certain markets). In fixed income, most of the demand has been for government bonds - primarily for liquidity purposes. The extent to which we've been able to meet this demand has largely been a function of the underlying client's appetite for collateral flexibility and term structures.

Jerry May: The percentage of our portfolio that is outstanding at any point in time ranges from 10-20 per cent, depending on time of year, and other factors that influence the desirability of different parts of the portfolio. This percentage has remained fairly stable over the last five to seven years.

Gerard Moore: We generally might have five to 10 per cent of lendables out on loan, with the volume peaking above this level during European dividend season. This dimension is of course subject to different tax regimes accepting the "European free movement of capital" principle, aimed at equalising tax treatment across jurisdictions. As more countries fall in line, so pension funds get more tax recovered, but at the loss of securities lending income.

There have been three main drivers of volume changes. Primary has been the level of demand relative to supply in the market generally. In additional, we have moved some mandates, particularly in established, mature markets, from segregated accounts to pooled vehicles, which has reduced the our lendable supply. Finally, we have been looking for opportunities to take advantage of term loans, for example over scrip dividend opportunities.

SLT: How have the regulatory changes of the past couple of years affected your securities lending programmes?

Moore: My community of local government pension funds are regulated by the Department of Communities and Local Government, and not by the FSA. As a result they are subject to a different set of "rules", which usually results in a more cautious approach being taken to investing generally, and certainly far more conservative in its approach to securities lending. A relatively simple approach meant that obtaining a decent return rather than maximising potential income has been the most common objective.

The regulatory changes haven't had too much impact on the lending programmes. Changes

in lending policies were primarily due to the reaction to the Lehman Bros collapse. Some funds withdrew from the market to re-examine the risk/reward balance. Most, but not all, have returned.

Bimpong: To date the impact has been an indirect one. Regulatory change and uncertainty, particularly with regard to restrictions and reporting requirements on short selling, have led to reduced hedge fund/PB borrowing demand (as well as potentially damaging efficiency and liquidity in the underlying market). By contrast, new rules on bank regulatory capital and liquidity have led to a further increase in demand for government bonds - particularly for term financing structures. Looking forward, from a European insurance industry perspective, the EU Solvency 2 directive looks set to have a profound effect on our clients' asset allocation strategy, with a knock-on impact on securities lending activity.

Johnson: It has not affected our programme, However we continue to review and ensure our programme is sound on a risk and regulatory basis

May: The regulatory changes that most affect our securities lending activity are the money market reforms that have been implemented, and as a result the reduced yield of those instruments. Money market funds are a tactical tool that we utilise in the reinvestment of our securities lending cash collateral, and this regulatory change has further narrowed spreads on lending transactions.

SLT: With margins increasingly tight on securities lending transactions, is it still worth lending general collateral?

Bimpong: Provided that the proper controls and procedures are in place, securities lending (even for GC) can still make a significant contribution to fund revenue for comparatively little risk. So, in a word, yes.

Moore: For local authority pension funds, income from securities lending tends to represent a useful additional income stream rather than being a key requirement. In previous times, it was sometimes seen as a means of offsetting or entirely covering costs of custody of assets, and was perhaps over-dependent upon the advice of the custodian as agent lender. Post Lehman, with the emphasis on education and risk management, there is greater awareness of the associated risks, and the nature of the risk curve, especially regarding the re-investment of cash collateral, as well as a greater awareness of other routes to market. This has meant that those larger funds which can comfortably accommodate and resource the explicit need for education and in-house expertise are more likely to remain in the market as a source of lendable supply.

For smaller funds, there is the same need for in-house expertise, but with potentially smaller income streams on the table, securities lending might well drop down their priority list. Wisely, there is an ongoing emphasis on offering accessible specialist training, which is of particular importance to smaller funds. The final point here is that there will be increasing prominence given to governance issues, especially in relation to the voting of shares.

May: We believe that general collateral lending is still a viable market, provided that it is balanced with specials, and that cash portfolios are able to achieve a spread to GC with little incremental risk. This could conceivably change if the current zero interest rate policy is maintained by the Fed for a longer than anticipated amount of time, but there are still opportunities if one is prudent in managing both the liability and asset portions of the trade.

Moore: This I see as the curve ball. One's initial "uneducated" response was "hang on, you mean I am lending out my securities and I am expected to offer collateral, and / or take a haircut?

Johnson: It is less attractive now than it has been in the past, but I would expect this might improve as more participants exit from lending general collateral.

We relaxed our investment guidelines to increase the yield on our invested collateral pool after the financial crisis as we believe it is better to be more aggressive after negative credit events and less aggressive after extended periods of good credit markets.

SLT: What is your attitude towards cash vs non-cash collateral?

Bimpong: There's nothing intrinsically more or less risky about cash vs non-cash collateral- the quantum of risk depends on how you reinvest that cash, compared with your non-cash collateral criteria. Having said that, it can be argued that some beneficial owners were unaware of the true nature and extent of the risks to which they were exposed in their cash reinvestment programmes going into the 2008 crisis. Appetite for cash vs non-cash varies by client - good agent lenders like ourselves should be able to support both.

Johnson: At this time we mainly require cash collateral, however, given the issues that occurred in the financial crisis of 2008. We are reviewing if non-cash collateral might be a good alternative.

Moore: Traditionally most local authority pension funds have taken G10 Sovereign Debt as collateral.

Fundamentally funds would be looking for a strong indemnity, and for all collateral issues to be covered by this. Hence, as a conservative approach, taking cash, usually not covered by the indemnity, has been the exception rather than the rule, and this proved wise during the Lehman's outcomes. Now there is much greater appreciation of the need to fully understand the nature of each cash reinvestment vehicle offered via one's agent lender. As such, not withstanding being possibly outside the indemnity, there might well be a greater appetite to move to cash collateral as the risks are now far better understood.

SLT: Do the introduction of CCPs make you feel more comfortable about expanding your securities lending programme?

Johnson: No, I do not think this affects the risk structure of the market.

Moore: This I see as the curve ball. One's initial "uneducated" response was "hang on, you mean I am lending out my securities and I am expected to offer collateral, and/or take a haircut?" It is an area requiring a better understanding of the advantages and disadvantaged from both risk and reward perspectives, and until this, has been acquired, the jury is still out.

Bimpong: The introduction of CCPs is certainly not a panacea. Most beneficial owners will not have the capacity to be direct members of a CCP, and will have trade via a clearing member. This implies concentration, rather than diversification, of risk. The requirement to post initial margin (as opposed to receive it) is an issue, as is the standardisation of collateral criteria required by a CCP model. Our clients are certainly not rushing to embrace the CCP model - if anything, the opposite is the case. Unless compelled to by direct regulatory fiat (unlikely) or indirectly via pressure from borrowers (possible, but we've seen no evidence of this to date), the beneficial owners in our programme will not be trading via a CCP any time soon.

May: The expansion of our securities lending programme would not be dependent upon the introduction of CCPs. CCPs may provide another route to market, or value add proposition in the right circumstances, but the information that I have reviewed thus far seems to indicate that they will not be a significant source of lending revenue for some time. **SLT**

The big beast

Every financial institution has been gearing up for one of the biggest regulatory changes in years. But what does it mean for securities lending?

BEN WILKIE REPORTS

Basel III is arguably most talked about piece of regulation affecting the global banking sector since the financial crisis. Given the sector's role in the securities lending industry, the implications of this upcoming regulation to the industry is becoming increasingly more talked about. Basel III will provide new global regulatory standards on bank capital adequacy and liquidity. It aims to avoid another financial crisis by requiring banks to have enough capital to ensure the amount that they lend matches the amount they have on their balance sheets.

The new bank capital and liquidity framework, which was endorsed by G20 leaders in November last year, sets out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio to support the risk-based requirement, measures to promote the build up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards.

A G20 communique said the framework aims to increase the resilience of the global banking system by raising the quality, quantity and international consistency of bank capital and liquidity, constrains the build-up of leverage and maturity mismatches, and introduces capital buffers above the minimum requirements that can be drawn upon in bad times.

The new standards will markedly reduce banks' incentive to take excessive risks, lower the likelihood and severity of future crises, and enable banks to withstand - without extraordinary government support - stresses of a magnitude associated with the recent financial crisis.

Allen Postlethwaite, chief executive officer of European securities trading platform SecFinex, explains that under Basel III, banks may have to consider their options to minimise the effects of the higher capital ratios imposed, among the options available are restructuring, reducing, cutting or finding another way to carry out their business. Secfinex has made its own calculations to demonstrate the Basel III effect. To do this it used a standard form of calculating the risk and therefore the capital requirement. Postlethwaite adds that banks have different ways of calculating risk, including the use of internal risk models approved by regulators, so the actual answers may vary.

The new Basel III framework will be translated into national laws and regulations, and will be implemented starting on January 1, 2013 and fully phased in by January 1, 2019.

However, Lord Turner, chairman of the UK Financial Services Authority, has said that the current regulatory framework is only the beginning and that as new financial instruments and risks are introduced, further regulation may be necessary: "The pre-crisis delusion was that the financial system, subject to the then defined set of rules, had an inherent tendency towards efficient and stable risk dispersion. The temptation post-crisis is to imagine that if only we can discover and correct specific imperfections – such as bad incentives or industry structure – that a permanently more stable financial system can be achieved," he said.

One other criticism of Basel III is that it maintains the status quo in terms of how financial organisations structure themselves. Dr Mario Onorato, head of balance sheet & capital management at Algorithmics, and honorary senior lecturer, Cass Business School in London says the new rules fail to reflect the true relationship between liquidity and capital: “Continuing to view capital as a primary mitigant of liquidity risk fails to recognise the complete nature of liquidity risk,” he says. “Should a liquidity situation arise and the bank uses reserves set aside to absorb losses and meet obligations, the value of the company and of the capital are also likely to decline, because the bank will begin to be perceived as ‘riskier’. Liquidity risk and capital are therefore inextricably linked and cannot be addressed as separate silos.

The use of a CCP could ensure reduced and centralised counterparty risks for market participants and improved operational efficiency in the post-trade environment

“A truly effective risk management system will take a holistic approach to risk measurement and reporting; viewing and managing the interconnections between all risk factors, such that their potential impact on the balance sheet and stakeholders’ interests can be properly accounted for.”

How does it affect securities lending?

As a consequence of the increased capital requirements and volatility adjusted risk calculations contained in Basel III, it will be more capital efficient to use a CCP in securities lending transactions. The use of a CCP could ensure reduced and centralised counterparty risks for market participants and improved operational efficiency in the post-trade environment. Furthermore, regulators in some domiciles see CCPs as risk free counterparties from a regulatory point of view and for this reason the exposure of a clearing member to a CCP is not required to be covered with regulatory capital. Beneficial owners have already used CCPs in other instruments they trade, including derivatives, notes Postlethwaite.

CCPs not only reduce counterparty risk and credit exposures for the individual market participants, but it also introduces a considerable reduction in systemic risk for the market in its entirety, said Eurex Clearing in a letter to ISLA in 2009.

Secfinex currently connects to two CCPs for securities lending transactions. Postlethwaite observes that in addition to bringing operational efficiencies in a post trade environment, CCPs reduce the risk of systemic failure and provide robust risk management systems. “Collateral management is simplified as there is only a single counterparty to manage,” he says. “CCPs are viewed as similar to AAA counterparties, in terms of capital requirements for counterparty credit risk. However, it is likely that there will be a requirement to apply a two per cent risk weighting to CCPs,” he says.

“The adoption of the CCP model in the securities lending space is not a regulation – yet – but it could be,” says Rajen Shah, managing director, global head of collateral management and EMEA head of securities finance at Citi. “A regulatory mandate is a possibility because regulators view a CCP as a way to reduce counterparty risk because a lender’s risk is with the CCP and not with any of the borrowers.

“Our view is that the securities lending market will not evolve into a pure CCP model, but there will be a certain percentage of business – perhaps as much as 30 per cent – that flows through a CCP.”

The best way of analysing the shift towards the use of a CCP for securities lending transactions, Postlethwaite says, is to look at the results of an industry poll undertaken at the Clearstream-hosted Global Securities Finance summit in January. Several hundred delegates were surveyed on key trends affecting the securities lending industry under Basel III. About 45.8 per cent of delegates surveyed said more collateral will be posted to CCPs for centrally cleared transactions and secured funding, while 30.5 per cent said more collateral will be given to interbank transactions and 15.3 per cent said more colateral will go to central banks for access to liquidity and monetary policy. 48.7 per cent of delegates (accounting for most of the vote) said they should be early adopters of the new CCP services for OTC derivatives and securities lending. 47.7 per cent of delegates (accounting for most of the vote), said regulators still need to do more work to address the issue of system liquidity risk.

50 per cent of delegates (accounting for most of the vote) said the important issue for a CCP was to ensure proper risk management and default or liquidation procedures. 44.5 per cent of delegates (accounting for most of the vote) said the need for additional collateral for purposes like the liquidity buffer under Basel III would not have a negative impact on the growth of the repo market while 38.1 per cent said it would. 35.2 per cent of delegates (accounting for most of the vote) said Basel III liquidity and capital rules will most impact the use of a CCP for repo transactions.

Another case for the movement of securities lending transactions through a CCP under Basel III is contained in a McKinsey study of banks’ balance sheets last year. The study estimated that EUR1.1 trillion of additional capital would be required to maintain the same level of business under Basel III regulations. “If banks raise all this capital they will probably take a hard look at the business lines it is used for,” says Postlethwaite, “and if they conclude that at least some of it could be saved by putting securities lending through a CCP, then why wouldn’t they?” **SLT**

Basel III milestones:

2010 – November: G20 endorses Basel III

2011 – Core principles revised as a result of the Financial Stability Board’s recommendations.

2013 – Liquidity Coverage Ratio (LCR) impact assessment and revisions as required

2015 – Short-term LCR standards released

2016 – Net Stable Funding Ratio (NSFR) impact assessment and revisions as required

2017 – Final review and adjustments

2018 – January 1: Pillar 1 treatment – Basel III implemented

2018 – NSFR minimum standards put in place

View from the top

As CASLA prepares for its inaugural conference, we ask industry professionals for their views on the securities lending market in Canada.

Ben Wilkie, editor

Robert Chiuch
President
CASLA

Rob Ferguson
Co-head, global securities lending
CIBC Mellon

Yvonne Wylie
Head, securities lending
RBC Dexia Investor Services

Warren Maynard
VP Canadian account management
State Street Securities Finance

Dave Sedman
SVP and head of securities lending Canada
Northern Trust

Meeting you....
We look forward to meeting many of you at the CASLA event
Justin Lawson, publisher

SLT: Has Canada's relatively benign path through the global downturn resulted in more securities lending activity in recent years?

Yvonne Wylie: The Canadian market is generally more conservative and risk averse than in the United States or Europe and as a result was less affected by the downturn. With Canada still being predominately a non-cash collateral market, the challenges relating to the cash reinvestment programmes experienced in other markets was not prevalent. However, the demand and supply dynamics have changed globally and Canada was not immune to this. Demand is still somewhat subdued as short interest, volatility, leverage and M&A activity remain below pre-crisis levels. While the supply side was not significantly impacted during the crisis, Canadian lenders that temporarily suspended their lending programmes have since returned to securities lending after re-considering the programme attributes that most suited their risk-reward profile. We are unlikely to see the volumes of 2007/2008 in the near future but current activity is a good indicator of a positive outlook.

Dave Sedman: Although the market remains subdued and Canada has experienced reductions in hedge fund activity similar to the rest of the world, Northern Trust Canada has experienced a significant increase in securities lending activity over the last few years. Our on-loan balances have increased over 40 per cent since 2009, mostly driven by Canadian equity and fixed income demand. While some of the increase can be attributed to market appreciation, the majority of the increase has been due to a greater number of securities lending transactions as well as larger trades.

Warren Maynard: No, the global downturn and contagion affect with the Lehman Bros default has impacted Canadian borrowers and lenders as well as their global counterparts. The business is very intertwined these days and supply and demand for Canadian securities comes from all corners of the globe. When demand is down globally this has a negative impact on Canadian participants as well.

Rob Ferguson: While it's true that Canada fared relatively well compared to other markets, the reality is that we're not immune to the effects of a global economic downturn. As a global lender, we lend securities from global markets to borrowers around the world. Lending programmes can be adversely affected by a number of events: decreasing hedge funds activity contracts, lower equity prices or fewer M&A deals, for example.

That said, the strength of Canada's banks and Canada's financial system certainly provided a measure of comfort to our lending clients. As a result, we didn't see significant numbers of Canadian clients exiting securities lending programmes. Also, while short term reinvestment markets experienced some problems, our reinvestment portfolios were well-positioned and performed extremely well for our clients.

SLT: In the current environment of subdued demand, limited specials and low interest rates what opportunities exist in the market to enhance returns?

Sedman: There have been slight increases recently in mergers and acquisition activity, which may indicate that demand will increase going forward. Other opportunities existing in the market today which could help to enhance returns are collateral expansion and flexibility, as well as technology advancements.

Maynard: To enhance returns, you can increase loan volumes of general collateral type activities, increase your risk profile for collateral or both. State Street works with all of our lending clients to explore opportunities around the expansion of their acceptable borrower base and/or their appetite for expansion of acceptable non cash collateral requirements. Other opportunities to potentially enhance loan returns would include strategies related to term trades and pre-determined guarantees on dividend elections.

Wylie: Opportunities exist in flexibility and this can be a differentiator for any programme. This would include collateral types, collateral margin levels, new deal structures, enhanced execution capabilities and exploiting untapped sources of supply and demand. Collateral flexibility from lenders is highly valued due to the widening cost differential between the various types of collateral. Since 2008 the cost of collateral has

been one of the most significant factors in determining demand. As profitability of this business is so dependent on demand, those that accept a broad range of instruments will appeal to a wider set of borrowers and therefore can benefit from increased utilisation levels or returns. Additional opportunities have also emerged from an ever tightening regulatory landscape with those willing to structure specific government bond trades for term. Once again it demonstrates that additional returns can be generated with a certain degree of flexibility.

Ferguson: While we haven't seen specials like those in the pre-crisis markets, and demand hasn't come back to 2008 levels, there has been improvement in the balances out on loan, a signal of improved demand. There has been a re-emergence of corporate activity in Canada, particularly M&A in the resource sector. As a result, overseas demand for Canadian securities has increased. On the technology side, the adoption of electronic trading and tri-party collateral services has provided efficient and cost-effective mechanisms for managing non-special lending.

SLT: Have the choices of collateral types changed in recent years?

Ferguson: Collateral flexibility is often cited as an important differentiator of lending programmes. We're able to give borrowers the choice between cash and non-cash collateral, as well as offer options on the non-cash collateral side - both bilaterally and through tri-party facilities. Clients in our lending programme are able to choose collateral classes that make sense for their needs.

Sedman: Similar to other markets, Canadian borrowers typically look to better manage their long inventories and reduce financing costs. In recent years, we have seen collateral parameters expand to include equities and corporate bonds. Beneficial owners with broader collateral guidelines tend to experience an increase in returns and utilisation.

> Ferguson: there has been improvement in the balances out on loan, a signal of improved demand

Wylie: In comparison to the US and other markets, Canada still remains a non-cash collateral market. Currently cash collateral represents 12 per cent of balances for Canadian lenders with reinvestment parameters tailored to each clients risk tolerance thresholds. For agent lenders like RBC Dexia, whose programme has always been geared towards optimising the intrinsic value of the loan as opposed to relying on the earnings from cash collateral reinvestment, there was no requirement to rapidly change to a more risk-averse profile as we were already there. Instead, the focus was on ensuring concentration, correlation and counterparty risks were within stringently set parameters. From a non-cash perspective we have seen an increase in the range of non-cash collateral instruments by lenders in recent years. Acceptance of alternative forms of collateral such as corporate bonds and equities has materialised. Equities, when taken as collateral, can add value in terms of earnings without adding additional risk. In this instance, the collateral is better correlated to the corresponding equity loans, haircuts are higher and ease of liquidity exists. Recent studies have indicated that it is safer to hold a component of equities in a portfolio than purely bonds.

Maynard: For Canadian lenders, acceptable collateral choices have been a bit of a dichotomy between cash and non cash collateral. With respect to cash collateral, lenders have been looking to reign in the risk profile of their cash collateral investments as well as reduce the overall average term to maturity of their cash investments. We are also seeing a movement towards segregated cash collateral mandates providing greater customisation and portability for the lenders. Canada has historically been a non cash collateral lending environment but over the last four or five years, cash collateral lending has grown to be as high as 20 per cent of the overall lending market. On the non cash side we are seeing clients expand the types of non cash collateral instruments they are willing to take in order to enhance the attractiveness of their securities, as well as loan returns. The expansion of non cash collateral includes adding equities and a broader range of widely traded debt instruments.

SLT: How has CASLA's founding affected the Canadian securities lending industry?

Robert Chiuch: CASLA has created a new awareness of the securities lending market in the country, and increased enhanced the popularity knowledge of the product. Its breadth and scope is both domestic and international and it aims to bring transparency to the local market and work with participants on both sides of the fence.

Wylie: CASLA has had a very positive affect on the Canadian securities lending industry and RBC Dexia is proud to be one of the founding members. CASLA is designed to give the industry a unified voice specific to the Canadian legal and regulatory framework, with the involvement of all market participants. The establishment of a forum where regulators and stakeholders can address pertinent issues will play an important part in the further successful evolution of Canada's securities lending market as the regulatory landscape continues to evolve.

> Chiuch: CASLA has created a new awareness of the securities lending market in the country, and increased enhanced the popularity knowledge of the product

Sedman: CASLA has had a positive influence on the Canadian securities lending industry, providing a singular and unified voice on behalf of the industry and its market participants. CASLA works directly with Canadian regulators and stakeholders on issues that are relevant to its members. In short order, CASLA has been successful in lobbying for the change in prescribed market rules in Canada, as well as for changes in the treatment of withholding tax on cross border rebates. These changes have led to increased opportunities to generate revenue and on-loan balances.

Maynard: CASLA's founding has at its core brought Canadian lenders and borrowers a voice in the global community with respect to activities, regulations and events which impact the securities lending industry. CASLA is working to bring all Canadian securities lending participants together in a single forum to create awareness, educate and opine on industry related topics. CASLA subcommittees have to date, enjoyed successes with regards to tax and regulatory reforms for Canadian lenders and borrowers and is currently in the process of reviewing and identifying best market practices for its Canadian constituents.

Ferguson: CASLA formalised the collaborative efforts of Canadian industry participants and allows a broad spectrum of both direct and indirect industry participants to participate in key discussions around industry issues: tax, legal, regulatory and more. This allows a broader view to contribute to the voice of the industry.

SLT: Has there been an increased focus on risk-adjusted returns and changing collateral types following the global downturn?

Sedman: There has been increased focus on risk-adjusted returns and, in some cases, we have seen clients move to more customised and conservative collateral guidelines. Northern Trust has a pattern of showing full flexibility in tailoring our clients' programmes to their specific needs. Clients participating in Northern Trust's securities lending programme may actively control, customise, and monitor their programme through selecting appropriate collateral guidelines and options, establishing limits and restrictions, utilising powerful tools and resources to maximise transparency, and exploring alternative lending solutions and flexible fee arrangements. This is consistent with our organisational culture of putting clients first in all matters.

Ferguson: As a value lender, we've always been focused on risk-adjusted returns, a strategy that served us well during the credit crisis. The positive side to the downturn is that it sparked dialogue among securities lending participants, particularly around the risk/return model, and it provided an opportunity for them to re-examine their participation. In 2008, all eyes were focused on risk; since then we've returned to a healthy balance between risk and return.

Maynard: Yes, there has definitely been an increased focus and transparency on risk-adjusted returns as lenders review their programme dynamics. We expect this focus to continue for clients that participate in cash collateral investment programmes going forward. On the non cash collateral side, clients are looking to seize opportunities to enhance their lending returns by expanding the types of acceptable collateral their programmes will permit along with reviewing their programme indemnification options.

> Maynard: Yes, there has definitely been an increased focus and transparency on risk-adjusted returns as lenders review their programme dynamics. We expect this focus to continue

Wylie: The financial crisis underlined the critical need for beneficial owners and investment managers to fully analyse and understand the relative risk/return ratios inherent in their lending programmes, and the collateral management services supporting them. As a result, risk-adjusted-returns are now the basis of comparison and the sole focus on revenue generation is seen as a secondary component compared to risk mitigation. Despite the challenges that the industry has faced, there are opportunities available to earn competitive returns while adhering to a prudent risk management framework. Having dynamic risk and collateral management capabilities is crucial and makes providers more responsive to a client's changing strategies and market conditions.

SLT: How has the regulatory environment changed over the past couple of years? How much is Dodd Frank and other US regulation affecting the Canadian market?

Wylie: There have been a number of notable changes over the years that have helped advance our industry and ensured that the Canadian market is not at a competitive disadvantage to other global jurisdictions. The elimination of withholding tax on arm's length payments from Canadian residents allowed for the expansion of cross border cash collateral lending. This had been one of the deterrents in evolving the market from non-cash collateral to a cash market.

A significant change to the Canada Income Tax Act and the regulations governing securities

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lending transactions eliminated the concept of prescribed exchanges that had restricted the security markets from which securities lending could be conducted for Canadian resident clients. And most recently the Investment Industry Regulatory Organisation of Canada (IIROC) has announced plans to remove restrictions on short selling in falling markets. Under the Proposed Amendments, IIROC would proceed with the outstanding proposal to repeal the uptick test but will also continue to work with other Canadian regulators to enhance measures intended to identify and address incidents of "abusive" short selling.

These amendments to the regulatory landscape are positive for the industry and demonstrate an acknowledgement of the importance of securities lending to capital markets.

Wylie: The US has undertaken considerable changes to its regulatory landscape as a result of the recent financial crisis. Dodd Frank is increasingly shaping the future of the US banking industry

Sedman: There have been a few regulatory and tax changes in the past few years that have allowed the Canadian market to continue to expand and grow. There was the changing of the "qualified security" definition in the Tax Act which allowed for securities lending in markets where previously Canadian participants were not allowed. After lobbying, the "qualified security" definition was broadened to include any security traded on any exchange globally. Until then, Canadian market participants were at a distinct disadvantage by not being able to lend in certain markets. Another change positively impacting the Canadian market occurred when the withholding tax on fees and interest on cross-border transactions was eliminated.

Wylie: The US has undertaken considerable changes to its regulatory landscape as a result of the recent financial crisis. Dodd Frank is increasingly shaping the future of the US banking industry. The Canadian market engages with US banks in a broad range of securities lending activities and these changes to the US regulatory landscape are expected to influence the development of the Canadian market. As there is still some uncertainty about the overall impact we remain engaged with industry associations and legislative groups to keep abreast of these transformational developments.

Maynard: Over the last couple of years the regulatory market in Canada has been loosened up as cross border tax implications have been eliminated, and as the restrictions on the number of lending markets that our clients can lend in have been removed. In Canada, we used to be restricted to lending Canadian clients' assets in markets where there were prescribed stock exchanges, as securities lending was tied to restrictions around individual Canadian investment restrictions. We approached the regulators as a unified industry to have the prescribed stock exchange limitations for securities lending de-coupled from those for individual investors, and allow our lenders lend their assets in all markets where lending is permitted.

As for the Dodd Frank regulation, this will greatly impact all of our lending clients as well as Canadian lending clients in that diversification caps of 25 per cent limits per borrowing counterparty could reduce the amount of lending that can be undertaken.

Chiuch: We're certainly aware of Dodd Frank and we're paying close attention to it as it evolves, but it is not yet complete and we are still awaiting further guidance in the US. The securities lending language - Section 984B - is still pretty vague, it's seemingly more of a work in progress in many respects at the moment.

Away from Dodd Frank, we're keeping a close eye on the FATCA tax regulations. It's one of the most significant tax events to affect our industry in a generation. The IRS recently released new guidance in IRS Notice 2011-34.

SLT: How will the new capital requirements of Basel III impact the securities lending industry?

Maynard: Basel III will present both opportunities and challenges for the securities lending industry with respect to collateral management. Raising the capital that a Bank is required to hold could limit the amount of business that a bank can undertake. In Canada it could have wide ranging impacts on the principle lending activities that take place. Banks that have the infrastructure and take a proactive stance and continue with market analysis of collateral management and transparency will benefit most through the regulations.

Sedman: While the full effects of Basel III remain to be seen, the changes in capital and liquidity requirements are likely to impact both lenders and borrowers in the industry

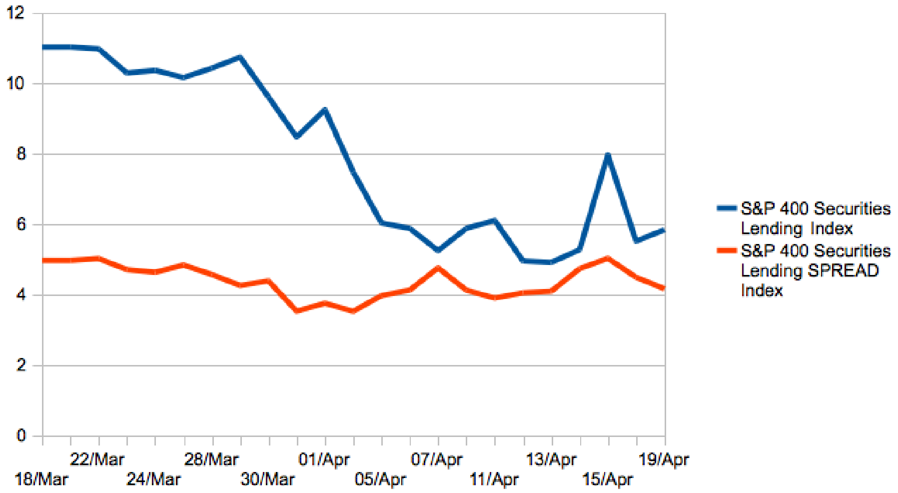
Wylie: The Basel III reforms will raise the quantity and quality of the regulatory capital required to be maintained by banks. As a result banks will increasingly seek to optimise the use of their capital including capital allocated to their securities lending activities. Basel III is also introducing leverage and liquidity measures that are expected to influence the direction and term of securities lending transactions and finally, Basel III is increasing incentives to use central counterparties. This may lead to the wider acceptance and influence the development of the CCP model in the securities lending market place in order to reduce capital charges.

Sedman: While the full effects of Basel III remain to be seen, the changes in capital and liquidity requirements are likely to impact both lenders and borrowers in the industry. The new capital requirements should create stronger counterparties, and firms with collateral flexibility will likely benefit the most. Many firms have begun to implement some of these changes and anticipate additional requirements from local regulatory agencies. Many Canadian banks are already in compliance with the Basel III tier I requirements.

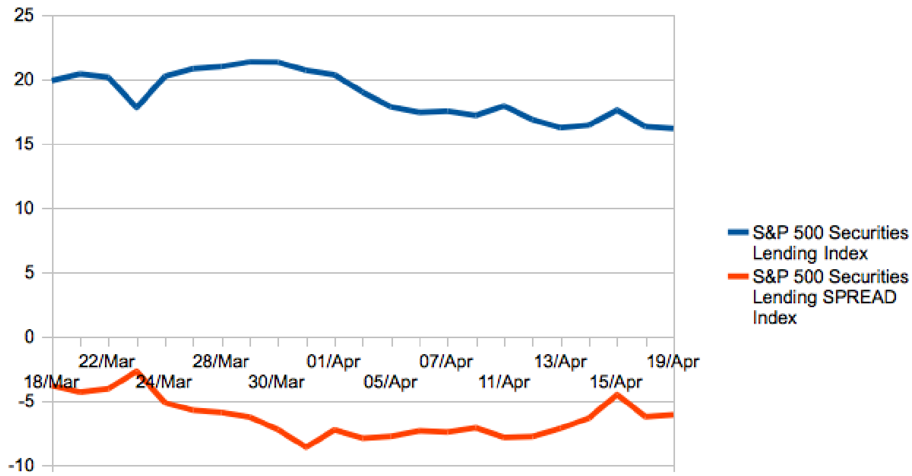
Chiuch: There is a heightened sensitivity to new policy and regulatory matters in risk, tax, credit and balance sheet, such as Basel III, especially in terms of the implimentation and compliance implications for the industry. An industry association is key to bringing a collective voice to any discussions. **SLT**

S&P INDICES

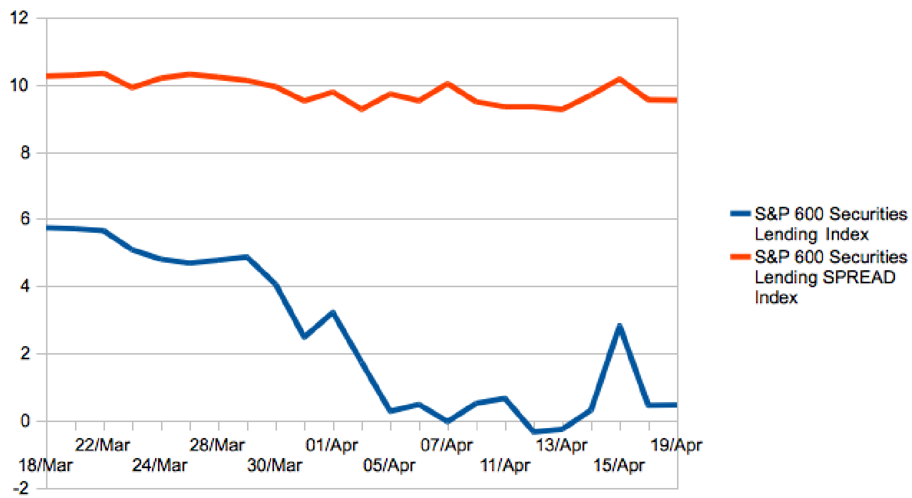
While on a general downward curve over the past month, the S&P 400 Securities Lending Index saw significantly higher volatility compared to the Spread Index in the middle of the month.



It's slow and steady for the S&P 500 Securities Lending Index, with a negative outlook on the Spread Index.



Again, the S&P 600 Securities Lending Index saw higher volatility than the Spread in mid-April, although the downward trajectory continued.



Fund exchange

The attacks on ETFs include securities lending, says Data Explorers'

DATA PROFILE

"What is worse than being talked about is not being talked about," said Oscar Wilde in The Picture of Dorian Gray. This should console those in the ETF industry licking their wounds after last week's three pronged attack from no less than the G20's Financial Stability Board (FSB), the IMF and the Bank for International Settlements (BIS). ETFs importance to securities financing is growing all the time so it makes sense to review these reports since securities lending is included in the list of issues cited by the FSB. It makes sense to begin by reviewing which ETFs are seeing most flow from those investors oblivious to the industry politics.

The ETFs - SPDR S&P500 (NYSE:SPY), Powershares QQQ (NADSAQ:QQQQ) and iShares Russell 2000 (NYSE:IWM) - that physically track the world's largest equity indices typically top the table of those seeing the most securities lending. Plus, the trend to invest in both gold and emerging markets makes ETF related instruments popular for hedging such that SPDR Gold Shares (NYSE:GLD) and iShares MSCI Emerging Markets (NYSE:EEM) are perennial favorites to borrow these days.

> The FT presented the arguments that ETFs make shorting too "easy" and thereby encourage it where it wouldn't normally occur. However, those advocates should be mindful of an equally easy counter-argument

More recently popular to borrow is (Bank of America) Merrill Lynch's Semiconductor ETF (NYSE:SMH). There is also recent momentum in demand to borrow natural gas themed ETFs, particularly ETFS Lev Nat Gas (BIT:LNGA), ETFS Natural Gas (BIT:NGAS) and United States Natural Gas Fund (NYSE:UNG). This could be to hedge long positions given the focus on this form of energy, as oil and nuclear suffer. As with all ETF borrowing there are typically two motivations: to hedge a long position in the sector through holding one or many single stocks, or to take a directional view to profit from falling prices in the sector, without long exposure.

The FT presented the arguments that ETFs make shorting too "easy" and thereby encourage it where it wouldn't normally occur. However, those advocates should be mindful of an equally easy counter-argument. We know from contact with the hedge fund community (especially in the US) that ETFs are mainly used to hedge their ownership of shares in case their bullish view is wrong. Given that hedge funds are paid to perform in all market conditions you can say that the existence of a liquid hedging tool such as an ETF is a pre-requisite to making an investment in the first place.

Much of the criticism contained in the reports was focused on synthetically backed ETFs, nicely summarised by Index Universe which explains the differences between funded and unfunded swap structures and the implications for collateral and risk weighted capital charges. However, physically backed ETFs (ie, those that actually own the underlying shares in the sector/index they represent) did not escape unscathed.

The fact that securities lending income is now recognised as the way in which ETFs can offer such low fund charges makes the report's authors suspicious. If the more you lend, the more you earn, it follows that the Boards presume that the issuers must be aggressively pushing their stock out the door. The authors are concerned that this makes short squeezes and price volatility more likely and creates unnecessary counterpart exposure. However, they fail to realize that you can only lend what someone else wants to borrow. Income from lending equities is well known to have fallen at least 40 per cent since the financial crisis due to vastly suppressed demand to borrow, yet this has not led to a rise in ETF fund changes. Therefore, securities lending income is clearly not the sole reason why charges are so low.

It is also worth pointing out what actually happened when the last counterpart defaulted, which was Lehman in 2008. Very little money was lost from those who had lent securities to Lehman. In fact, the rebound in the equity markets meant that many made money in the process of selling their collateral to buy back what was on loan to the defaulted counterpart.

Despite physical and synthetic ETF providers publishing more and more information about their business, (the ETF lending revenue split between the investor/fund manager, the SL revenue and the daily collateral schedule) people will always want more. There is currently a battle between the two types of ETF creators as to which can be the most transparent, meaning they are generally willing providers of information. This is exactly the situation the regulators want and is good for investors.

Having missed the dangerous implications of securitisation, committees of wise men are queuing up to pin every last sin upon an ETF. If you believe everything you read the world will end and ETFs will be to blame. Some of the more whacky accusations include fostering insider trading and discouraging companies from listing.

At this stage, it is hard to remember that ETFs actually offer a cheap, liquid and less risky way to invest. If financial "artistry" and innovation is to survive, one would do well to take another piece of advice from Mr. Wilde, ""The critic has to educate the public; the artist has to educate the critic."

To hear more on this join us at the NY Forum on 26 May. SLT is pleased to be Media Partner. **SLT**

Will Duff Gordon
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Industry Appointments

Chris Erickson is reported to be joining J.P. Morgan's prime brokerage division.

Erickson was previously chief operating officer at UBS prime brokerage, but left the firm in the midst of a range of other departures some months ago citing personal reasons.

Tim Wannenmacher is to join UBS as head of prime services for the Asia-Pacific region. He will replace David Gray, who has left the bank after 17 years.

Wannenmacher was previously global head of prime services and delta one at Nomura, having been part of the team that moved over from Lehman Brothers following that bank's default.

Jon Wedrogowski and **Jill Mandarino** have joined Kellner DiLeo's KDC Alpha Fund.

Wedrogowski joins as vice president and head of analytics at the fund. He moves from BlackRock and is a chartered alternative investment analyst with a MFE from Berkley and a BS from Duke universities.

Mandarino joins as a vice president trading ETFs. She spent three years at J.P. Morgan/ Bear Stearns, and has also worked at Daiwa and Nomura.

Paul Lynch has joined eSecLending as chief operating officer, effective April 25, 2011.

With over 20 years of financial service experience, Lynch has specialised in securities lending since 1996. Most recently, he was a senior managing director at Premier Global Securities Lending (PGSL). Prior to PGSL, Lynch was a senior managing director and head of global trading and risk management at State Street in its Securities Finance division.

During his 14 years at State Street he held several other senior roles in securities lending product development, operations and business development. Prior to State Street, Lynch held various positions at Mellon Trust, Coopers and Lybrand and Fidelity.

"I am pleased to be joining an innovative firm that has built a strong reputation and track record in successfully delivering securities financing solutions for their clients," said Lynch. "The industry has evolved significantly in recent years and it is clear that eSecLending is best positioned to respond to these changes. Their differentiated philosophy and approach are well suited to meet the needs of beneficial owners as they seek best in class providers for their investment objectives. I look forward to leveraging my experience to further enhance the firm's strategy and to help build on its continued success."

"We are delighted to welcome Paul to eSecLending as he brings extensive market knowledge and experience," said Karen O'Connor, eSecLending co-chief executive officer. "Paul is a proven leader and collaborator and his expertise in strategic planning, risk management and innovation will bring significant value to our firm and our clients."

Mercer Sentinel Group, has appointed **Arti Sharma** as principal and head of business development, North America.

Based in Toronto, Sharma will be responsible for the ongoing development of the Mercer Sentinel suite of products and services throughout North America.

"We're delighted to welcome Arti to the Mercer Sentinel team. She has an outstanding professional reputation and extensive experience in the custody industry," said Freeman Wood, Mercer Sentinel director of the Americas. "Her appointment is an important step in the expansion of Mercer's Sentinel service in North America."

Before joining Mercer Sentinel Group, Sharma was senior vice president at Thomas Murray North America Inc., a specialist custody consulting group headquartered in the UK. She specialised in new business development, consulting services and institutional investor relationship management.

The International Swaps and Derivatives Association has elected **Stephen O'Connor**, managing director, Morgan Stanley, as the association's new chairman.

O'Connor succeeds Eraj Shirvani, managing director, head of fixed income for EMEA Region, Credit Suisse, who has served as ISDA's chairman since April 2008. During Shirvani's three-year tenure as chairman, ISDA and the over-the-counter (OTC) derivatives industry undertook a number of initiatives to build safe, efficient markets. ISDA's Big Bang and Small Bang Protocols enabled greater process and product standardisation, the volume of cleared swaps increased significantly, bilateral risk management improved and trade repositories were established for credit default, interest rate and equity swaps. Shirvani will continue to serve on the Association's Board of Directors.

"Steve O'Connor has been very active at ISDA as a Board member and as chairman of the ISDA Industry Governance Committee," said Mr. Voldstad. "He is ideally suited to lead the Association and our industry forward as we work together to address the challenges and opportunities that lie ahead."

O'Connor has been a member of the ISDA Board since 2008. He joined Morgan Stanley in 1988 and is Global Head of OTC Client Clearing at Morgan Stanley. Mr. O'Connor graduated from Imperial College, London with a degree in Mechanical Engineering.

Ted Hall has joined FinTuition as European sales and marketing manager. In this role his main focus will be working with clients and prospects to assist in structuring courses, developing the portfolio of courses and looking for new opportunities in respect of FinTuition's curriculum.

Roy Zimmerhansl, owner of FinTuition commented: "I have known Ted for many years and believe his diverse background and experience, most recently in asset servicing, will be of great benefit to FinTuition's clients."

Over the course of almost twenty years in securities services, Hall has held senior roles in asset servicing, product management and relationship management at Bank of New York as well as positions at Lloyds Bank and NatWest in global custody, treasury, and securities lending.

BNY Mellon has appointed **Susan Skerritt** to lead global product management & strategic development for treasury services, with **Alan Verschoyle-King** named head of global sales & relationship management. Both will report directly to J. David Cruikshank, chief executive officer of BNY Mellon Treasury Services.

SECURITIESLENDINGTIMES

Editor: Ben Wilkie
editor@securitieslendingtimes.com
Tel: +44 (0)20 3006 2710

Marketing: Steven Lafferty
design@securitieslendingtimes.com

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
Tel: +44 (0)20 8249 0235
Fax: +44 (0)20 8711 5985

Associate publisher: Katie Wildeman
katie@securitieslendingtimes.com
Tel: +44 (0)1293 520594
Fax: +44 (0)20 8711 5985

Published by Black Knight Media Ltd

16 Bromley Road
Beckenham
Kent
BR3 5JE
UK

Company reg: 0719464

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Alexa Lemstra

In the latest of our 2011 series "A coffee with..." Securities Lending Times speaks with Alexa Lemstra of EquiLend. We look at how she made the big move to New York, relocated to Canada and her plans for the future.

Tell us about your career to date?

I made the big move to New York to work for the EquiLend client support team shortly after university graduation. Learning the platform at the most technical level, I was able to build a strong knowledge base that set the stage for moving into the Business Development team. The focus on relationship building and understanding the client's business was a good fit.

In Autumn 2008, I was tasked with opening the EquiLend Canada office to respond to the growing needs of the Canadian securities lending market. Over the last three years the office has grown to support monthly trading averages of 3 billion USD , BondLend fixed income trading, and many post trade services. Achieving registration as an Automated Trading System (ATS), building relationships with the Canadian client base, and overcoming the challenges of entering a new market has been an exciting time.

How did you find working through the industry's biggest ever crisis?

From a service provider perspective our experience was very different than that of our clients. As our clients were stretched and resources were needed in other areas, clients were able to rely on their relationship with EquiLend to process volumes, reduce risk, and take advantage of its efficiencies.

If there is one thing you could change about the industry what would it be?

More technology resources available to clients to help project prioritisation

What are your ambitions?

To make the EquiLend Canada office a strong and successful part of the global EquiLend organisation and the industry at large by being a valuable tool for our clients.

If you were given an unexpected USD 10 million bonus tomorrow what would you do?

I would research and educate myself on the most sustainable way to support local community and international development.

If you weren't working in securities lending what would you be doing?

Learning a new discipline, travelling and volunteering internationally, or start a local organic farm. **SLT**

Alexa Lemstra, business development

EquiLend Canada Inc.

The Exchange Tower | 130 King Street, Suite 1800
Toronto, On M5X 1E3
T: 416.865.3395 | F: 416.947.0167
E: alexa.lemstra@equilend.com