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SECURITIES**LENDING**TIMES

www.securitieslendingtimes.com

**ISSUE006**
10.08.2010 TUESDAY

# Bringing back the boom time

**BOSTON** 05.08.2010

The announcement by broker deal BTIG that it is expanding its prime brokerage platform in Boston is being seen as a sign that the industry is starting to move forward after two years of turmoil.

Existing hedge funds are ramping up their operations in the city, while there are a number of new launches expected over the coming months.

Mike McCuin and Adrianne Schulte have joined BTIG and join 12 existing specialists in equity and fixed income trading.

"We view Boston as an important strategic market. Having a local presence is vital to our success and demonstrates BTIG's commitment to the Boston investment community," said Justin Press, co-head of prime brokerage at BTIG.

McCuin joins BTIG's Boston office in prime brokerage sales. He has almost 10 years of experience in prime brokerage, sales and trading. Most recently, McCuin was in business development at Kaufman Rossin Fund Services. Prior to Kaufman Rossin, McCuin held positions at J.P. Morgan Prime Brokerage and CIBC World Markets.

Schulte joins BTIG's Boston office in prime brokerage relationship management. Most recently, Schulte was in client services at J.P. Morgan Prime Brokerage in New York. Prior to J.P. Morgan, Schulte was at Gemini Fund Services.

"Given the number of hedge funds in Boston right now and the expected new launches in the next few years, we think now is the time to add dedicated prime brokerage staff here," added Dan Patterson, managing director and head of BTIG's Boston office. "We expect new funds will be started by professionals currently at the larger institutions we cover in Boston and we are well positioned to become a strategic partner to them as they go through the start-up phase of their next venture."

BTIG's Prime Brokerage division was launched in January 2004 and caters to start-up and existing equity & fixed income hedge funds. The division has offices in New York, San Francisco, Dallas and Boston.

## NEWS**IN**BRIEF

### Citi to expand hedge fund platform

Citigroup's private bank will increase the number of hedge funds it offers on its platform, HedgeForum.

HedgeForum became part of Citi Private Bank in March. It currently manages just under USD 3 billion, and offers clients access to 24 hedge funds. David Bailin, head of managed investments at Citi Private Bank says the number will more than triple to 75 by the end of next year, increasing the value of funds under management by 'multiple' billions.

"The refocusing of the business is already being greeted with a lot of success, in terms of both inquiries and new business for Citi Private Bank," Bailin told Bloomberg.

One of the key aims surrounding the increase in funds, said Bailin, is to give Citi's clients more access to emerging markets.

### BlackRock looks to ETFs for shorts

BlackRock has applied for regulatory approval for the right to sell short when running exchange traded funds that track market indices.

The company wants to be allowed to create ETFs that can bet against stocks or bonds. The company's current ETFs are based on indices that buy stocks rather than selling them short.

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## BlackRock looks to ETFs for shorts

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It is believed that these new products will allow firms to expand into areas currently dominated by money managers using active strategies.

According to the application, BlackRock will offer ETFs based on indices that invest in long and short positions. The firm may later create funds that are based on indices that exclusively hold short positions. BlackRock also said that the new ETFs "anticipate using securities lending to a greater extent" than existing funds to enhance their investment strategies.

## Royal Berkshire seeks new custodian

The Royal County of Berkshire Pension Fund is soliciting tenders for a new global custodian.

The £1 billion fund has used HSBC Securities Services for the past 13 years, but has decided the new contract should be opened to the wider market. The offer is for an initial five year deal, with an option to renew for a further five years.

Interested parties should contact Mercer Sentinel and the deadline for submissions is 24 September.

## Illinois Teachers looking over the hedge

The Illinois Teachers Retirement System, the 68th largest pension fund in the world, is to invest approximately USD 400 million directly into 12 hedge funds, it has been announced.

Senior investment officer Kent Custer told trustees of the decision at the system's August board meeting. At a previous meeting, trustees voted to double the fund's hedge fund allocation to five per cent.

Its first direct investment was in 2008, when it allocated funds to Bridgewater Associates' Pure Alpha hedge fund. That allocation is now worth around USD 320 million.

The fund will select managers with the help of its existing fund of fund managers K2 advisors and Grosvenor Capital Management. The fund's consultant, RV Kuhns and Associates will provide further assistance. A shortlist of 15-20 hedge funds will be created, with an expectation that two to four funds will be added annually over the next two or three years. The first round of hires is expected to be in equity and credit strategies.

## Fiserv selects Omgeo ProtoColl

Fiserv, Inc. has announced that it will utilise Omgeo ProtoColl as its collateral management solution. Using Omgeo ProtoColl, new and existing Fiserv customers on the TradeFlowTM platform will be able to automate their collateral management process, handle numerous asset classes and increase visibility into credit exposure to mitigate counterparty risk.

"Organisations are struggling when it comes to understanding where all of their collateral resides, particularly when it comes to repossessions," said Paul Thomas, managing director, Investment Services, Fiserv. "We've seen intense pressure on the repossession market because of increased use of collateral agreements. By automating the collateral management process, clients will have a holistic view of their positions, which is invaluable to achieving the key goal of minimising counterparty risk. Using Omgeo ProtoColl, Fiserv clients will have the ability to quickly identify discrepancies and highlight which details must be resolved between existing counterparties."

Omgeo ProtoColl is designed with a sophisticated and configurable workflow to help streamline the collateral process. Its intuitive dashboard enables users to manage all tasks including notifications and exceptions from a single central location. Additionally, the extensive reporting capability ensures users are fully informed and deadlines are met.

"Today, a limited number of institutions are using automated collateral management solutions. Most existing processes have largely been manual via spreadsheets, increasing operational risk and the likelihood of errors," said Tim Keady, managing director, global sales and relationship management, Omgeo. "With access to a flexible, out-of-the-box solution such as Omgeo ProtoColl, Fiserv clients will be able to handle a surplus of collateral with increased accuracy and efficiency."

## NY Fed to begin reverse repo tests

The Federal Reserve Bank of New York has begun reverse repo tests to ensure the tools will be ready if the Federal Open Market Committee agrees to introduce the practice.

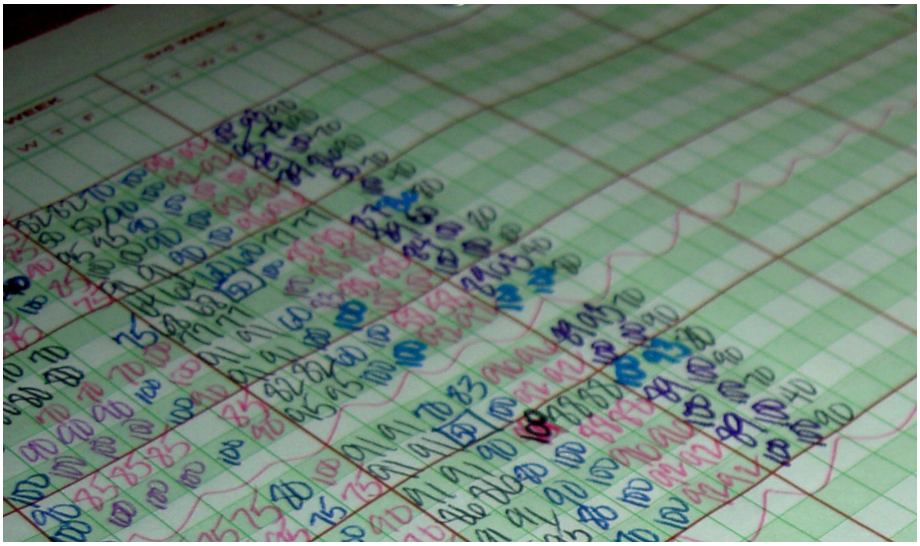
The New York Fed is conducting a series of small-scale, real-value reverse repurchase transactions with primary dealers using all eligible collateral types, including, for the first time, agency mortgage-backed securities (MBS) from the SOMA portfolio.

Like the earlier operational readiness exercises, this work is a matter of advance planning by the Federal Reserve. It does not represent any change in the stance of monetary policy, and the Fed warns that no inference should be drawn about the timing of any change in the stance of monetary policy in the future.

These forthcoming operations are being conducted to ensure operational readiness at the Federal Reserve, the triparty repo clearing banks, and the primary dealers. The operations have been designed to have no material impact on the availability of reserves or on market rates. Specifically, the aggregate amount of outstanding transactions will be very small relative to the level of excess reserves, and the transactions will be conducted at current market rates.

The results of these operations will be posted on the Federal Reserve Bank of New York's public website where all temporary open market operation results are posted.

## Merlin introduces new reporting functionalities



Merlin Securities has announced that it has launched new reporting functionalities that will enable funds to more precisely articulate their performance for institutional investors.

Merlin's clients can drill down and calculate additional required performance measures and ratios across multiple custodians for specific components of their portfolio: sector, market cap, industry, strategy, geography and a range of customisable user-defined components. Merlin's new functionality allows hedge funds to calculate and analyse their performance net of fees and expenses.

"In today's competitive marketing environment, hedge fund investors require greater transparency and more customisable reporting to allow them to understand a fund's performance across a variety of components," said Amr Mohamed, senior partner and chief technology officer at Merlin. "Our hedge fund clients can now provide more sophisticated insights into their performance with just a few clicks. For instance, a fund can articulate and segregate alpha contribution by sector, drawdown by market capitalisation and market risk exposure by geographic region. In addition, fund managers can also quickly generate their monthly performance analysis net of fees - a process that previously required manual input."

Merlin's new reporting functionality is available for the full range of measurements that investors demand, including Sharpe ratio, Treynor ratio, volatility, skew on returns, Alpha and Beta versus benchmark (including customised and blended benchmarks), up and down capture ratios, Sortino ratio and drawdown. These measures, in turn, can be isolated by sector, market cap, industry, strategy, geography - or by a customised criterion.

Additionally, whereas hedge funds historically have calculated their return-based statistics manually by spreadsheet, Merlin now provides a tool to automate that process. Managers can load their net returns into the system then seamlessly calculate all the analytics on a portfolio or component level based on net numbers.

"Today's hedge fund investors expect to be able to drill down into a portfolio and understand performance in ways that historically would have required hours of manual input and analysis," said Patrick McCurdy, partner and head of capital development at Merlin Securities. "Portfolio level analytics are no longer enough, and managers are searching for tools to help them deliver these metrics in a simple and cost-effective manner. We continually strive to provide our hedge fund clients with the tools and technology they need to showcase their performance and demonstrate their edge."

## BNY Mellon enhances reporting capabilities

BNY Mellon Asset Servicing has enhanced its Workbench platform to help institutional investors comply with new accounting standards that require them to report the industry ratings of their counterparties when over-the-counter (OTC) derivatives are held.

These enhancements were specifically designed to help US Government reporting clients meet the requirements of Governmental Accounting Standards Board (GASB) Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. The Workbench enhancement delivers the ratings from all three major agencies, Moody's, Standard & Poor's, and Fitch.

"We have expanded the counterparty exposure reporting for swaps and forwards to assist clients to efficiently determine ratings for their counterparties or any other legal entities or companies related to the counterparty," said Chris Richmond, managing director of global product accounting for BNY Mellon Asset Servicing. "Consolidating this data enables institutional investors to view their derivatives with greater transparency across accounting, counterparty and rating data and gain a more complete view of their portfolios."

The new service displays short and long-term ratings for counterparties and related entities as well as additional information about the underlying security or index. By combining accounting and analytical information, clients are able to see a consolidated view of their counterparty exposures. The new reporting functionality further extends the scope of BNY Mellon's Derivatives360, which supports derivatives throughout their lifecycle.

## DTCC launches equity derivatives reporting repository

The Depository Trust & Clearing Corporation (DTCC) has announced the launch of its Equity Derivatives Reporting Repository (EDRR) and FSA approval of DTCC Derivatives Repository Ltd subsidiary.

The building of the EDRR repository, follows a competitive request for proposal process (RFP) led by the International Swaps and Derivatives Association (ISDA) last year, and represents the industry's efforts to strengthen its operational infrastructure and improve transparency across all major OTC derivatives asset classes. All of the 14 global market dealers are now live on EDRR.

EDRR's central registry will hold key position data, including product types, notional value, open trade positions, maturity and currency denomination for participants' transactions, as well as counterparty type. OTC equity derivatives products the service will initially support include options; equity, dividend, variance and portfolio swaps; CFD (contracts for difference); accumulators and a final category covering other structured products.

By aggregating and maintaining the data, DTCC's EDRR will generate reports that keep industry participants and regulators up to date on the industry's outstanding notional and positions as well as other position related information through a single, secure, easy-to-access portal.

"DTCC played an important role in bringing this new service to market over an aggressive timeframe, allowing the OTC derivatives community to meet commitments made to global regulators to have a repository service running for equity derivatives by the end of July," said Patrick Dempsey, managing director and CFO, Global Equity Derivatives Group at J.P. Morgan and chairman of the International Swaps and Derivatives Association's (ISDA's) Equities Steering Committee, EDRR subgroup.

In addition, DTCC announced that its new European subsidiary, DTCC Derivatives Repository Ltd has received UK Financial Services Authority (FSA) approval to operate as an FSA regulated Service company. This new subsidiary will jointly house the global equity derivatives repository and will maintain global credit default swap data identical to that maintained in its New York based Trade Information Warehouse. The move is, in part, intended to help ensure that regulators globally have secure and unfettered access to global data on credit default swaps (CDS) by establishing identical CDS data sets on two different continents.

## OCC contract volume down

Total cleared volume at the Options Clearing Corporation (OCC) in July reached 279,245,228 contracts, representing a nine per cent decrease over the July 2009 volume of 307,085,331 contracts. However, average daily volume for 2010 is 15,816,927 contracts, a nine per cent increase compared to last year's average of 14,552,341 contracts. OCC's year-to-date total volume is up eight per cent with 2,293,454,442 contracts.

Exchange-listed options trading volume reached 277,370,315 contracts in July, a nine per cent decrease from July 2009. Index options trading rose one per cent from the previous July. Year-to-date average daily contract volume for exchange-listed options was up eight per cent compared to the same period last year.

Futures cleared by OCC in July rose to 1,874,913 contracts with a year-to-date average daily contract volume of 104,876. Equity futures volume reached 599,564 contracts, a 99 per cent increase over the same month last year when 301,574 were traded. Index and other futures volume came in at 1,274,969 this month and show a year-to-date average of 82,844 daily contracts.

OCC's stock loan program, including OTC and AQS, saw a 74 per cent increase in new loan activity over July 2009 with 54,659 new loan transactions in July. Year-to-date securities lending activity is up 58 per cent from 2009 with 340,426 new loan transactions in 2010. OCC's stock loan program had an average daily notional value of USD11,017,669,194 in July.

## Results round up

**Lloyds Banking Group** has returned to profitability following a multi-billion pound loss in 2009. For the first half of 2010, the Group recorded a profit before tax of £1.3 billion - compared to a £4 billion loss in the same period last year.

"The first half of 2010 was a significant milestone for Lloyds Banking Group as the Group returned to profit," said J Eric Daniels, group chief executive. "Despite the challenging economic environment, the core businesses performed strongly and we continued to see positive momentum across all of the key income statement line items: income, margins, costs and impairments and an extension of the positive business trends established in 2009. Given the business model we have established, coupled with the gradual recovery in economic growth in the UK, we continue to believe that the Group is well positioned to deliver a strong financial performance over the coming years."

**Royal Bank of Scotland**, one of the biggest casualties of the past couple of years and now 83 per cent owned by the UK Government, also had good news. First half profits for 2010 hit £9 million, compared to a loss of £1.04 billion in the same period last year. However, this year's profits were all made in the second quarter, as the period from April to June saw profits of £257 million, while the preceding three months registered a loss of £248 million. "The rebuilding of RBS is a marathon not a sprint," said chief executive Stephen Hester.

Operating profits for RBS totaled £1.6 billion for the first half, compared to a loss last year of £3.4 billion. Hester said: "RBS second quarter results show that the bank remains on track to meet the far-reaching goals of our five-year restructuring plan, which commenced last year.

"The economic and regulatory environment has the potential to delay or inhibit progress. However, we remain focused on what we can control: serving our customers better across our businesses and building relationships with each of them."

Profits for the first half of 2010 at **BNP Paribas** were up 39 per cent on the same period last year at EUR4.39 billion. However, market conditions at the moment are "unfavourable", said the bank's chief executive Baudoin Prot.

"All the operating division pursued their business development plans, thereby contributing, with the reduced cost of risk, to mighty profit generating capacity," added Prot.

France's second-largest bank (after BNP Paribas), **Société Générale**, announced a near-trebling of its second quarter profits. Net profit was up to EUR 1.08 billion from EUR 309 million a year ago. Meanwhile **Natixis**, which reported the largest net losses of any French bank as a result of the financial crisis, showed it's on the right path with the fourth straight profitable quarter. Net income was EUR 522 million, compared with a loss of EUR 819 million for the same period last year.

**HSBC**, which did comparatively well during the downturn, saw its shares rise after it announced pre tax profits for the first half of the year at £7 billion, more than double the same period in the previous year. The UK-based bank, which makes a significant part of its income from Asian and South American emerging markets, has reduced its bad debt provisions.

**Barclays** also posted strong figures. Pre-tax profits for the first six months totaled £3.95 billion - a 44 per cent rise on the same period last year. "The twin benefits of a broadly based set of banking activities - both by geography and business line - and sound risk management lie behind these results," said John Varley, chief executive.

# Bright light

## The advantages of exchange-traded securities lending may be obvious, but it requires a sea-change in the opinions and activities of market participants

**BEN WILKIE** REPORTS

Before stock trading went electronic, many traders were afraid of what could happen. Before futures and options trading went onto electronic exchange, the dealers believed their livelihoods would be destroyed. Today, those doubters are considered dinosaurs. So can OneChicago convince prime brokers, borrowers and beneficial owners that exchange-traded securities lending is the future?

Well, it's doing pretty well so far. Listings rise almost daily, and trading is reaching extraordinary levels. But there's still a long way to go.

"When I took over three years ago, people believed OneChicago was like a futures exchange," says David Downey, the exchange's chief executive officer. And this isn't surprising really, since it's owned by some of the biggest names in US markets, including IB Exchange Corp, CBOE and the mighty CME Group, which dominates futures and options in the US. "But single stock futures (SSFs) are a way to finance equity positions on more favourable terms to investors."

OneChicago uses a market maker system with a number of lead market makers, to guarantee liquidity. This means, says Downey, better fills and more importantly, lower costs. Someone on a margin account may be paying around 780 basis points for a margin loan in a brokerage account and they can carry the same delta position via the SSF with an embedded Fed Funds Rate, which as of today is 18 basis points.

"Short sellers will have to put up 102 per cent plus 30 per cent margin at the broker and they won't get any interest back," explains Downey. "That rate would also move, so they often wouldn't know the rate until after the trade. Algorhythmic traders would find this very difficult to price - but with us, because the interest rate that is built in can be determined through the SSF price, they always know."

### Efficiency arguments

While this is great for investors, there is one sector of the market that would instinctively reject such an idea: prime brokers. Taking securities lending on exchange has a huge impact for these vital participants, with many fearing the end of their business if it takes off.

"My customers are clearing members," explains Downey. "My customers are the only way to bring people in to trade products and SSF represent a potential threat. Our strategy is to show that brokers don't have enough inventory to satisfy customer needs - they need to borrow from pension and other funds. This process entails lending to custodians who re-lend to the prime brokers who re-lend to hedge funds. The funds accept this because they don't want the credit exposure to the hedge funds, but trading at OneChicago has the benefit of the AAA Options Clearing Corp novating all the transactions and thereby eliminating counterparty risk.

"This means that the borrowers and lenders have two intermediaries dealing with any trade, and that's just not cost-effective. We show how electronic access streamlines the process and securities lending is moving that way. In the meantime, the intermediaries will get squeezed out - it's the only way to get efficiencies into the market... This doesn't take prime brokers out of the business. It changes the way they do their business - it brings the OTC trades to an exchange and clear it."

## Education

Downey and his team have been touring the major firms spreading the gospel about OneChicago. And while the response has generally been good, some sectors have been harder to convince.

"A lot of people don't understand SSFs," he says. "A lot of people don't understand securities lending. It's an education process and that is what we have to do.

"Trying to get pension funds to move is very difficult. A lot of them lost a lot of money during the downturn via the reinvestment of the collateral, and that hurts people. They lost because they didn't understand the risk of reinvestment. Our pitch is that we make it easier and more transparent to lend and borrow via the Exchange Future for Physical (EFP) transaction whereby they capture the intrinsic value of the loan upfront and reduce the need to generate returns from collateral as the securities lending rebate is reflected in the SSF price."

One of the drivers for the increase in both interest and volumes has been the rise in new listings. "We can list any number of products," says Downey. "We asked out customer base what they wanted and we have delivered. Some of our earlier products have also been shelved because of a lack of interest.

Some of the new products we have isolate the impact of the dividend - firms have said they don't want any exposure to dividend changes, so we will have the OneChicago no dividend contract - the stock price and the interest equals the cost of the carry. At the time the stock pays a dividend we will isolate that impact."

The exchange is also working with the US Congress to get product recognition as securities lending on a formal basis. Some commentators consider securities lending as a standard sale of stock, which triggers a tax event, and the exchange is looking for clarification on the rules. At the moment, says Downey, there's no timeline for a decision yet, even though they have been working on it for three years.

## Volume growth

A different strand to OneChicago's strategy has been to encourage new entrants to drive the volume: "We have taken a number of initiatives to engage these firms," he says. "Not all firms who have wanted to get into prime brokerage have succeeded. There are large global institutions who have tried and failed to get a foothold in this business in the US.

"We pitched these firms to say they could service their customers with synthetic prime brokerage with these funds when they are offering financing. So these companies with international scope are saying we use these products overseas, we need to be doing it here! A lot of the volume growth has been these large firms dipping their toes in the water."

The exchange also hopes to encourage pension funds to become clearing members themselves, which would free up their cash. They will be able to post their margins at clearing provider the Options Clearing Corporation and free up their collateral and build the securities lending profit into the EFP transaction and not the reinvestment process.

"I'm firmly of the belief that everyone will act in their own best interests," concludes Downey. "And they will move to my way of thinking. If what our client firms are telling us is true, the levels we are seeing at the moment is just the tip of the iceberg. Companies are developing systems to work with OneChicago and we will be ready and willing to service them."

## 99 per cent growth

OneChicago reported some fantastic figures showing that 599,564 security futures contracts were traded at the Exchange in July 2010, an increase of 99 per cent from July 2009. Year to date volume was 2,591,742, up 143 per cent from 2009.

Open interest stood at 636,429 contracts at the end of July 2010, a 72 per cent increase over July 2009 and a 110 per cent increase over June 2010.

## The top five July volume OneChicago contracts are:

Intel Corporation
Pfizer, Inc.
The Proctor & Gamble Company.
Wal-Mart Stores, Inc.
AT&T Inc.

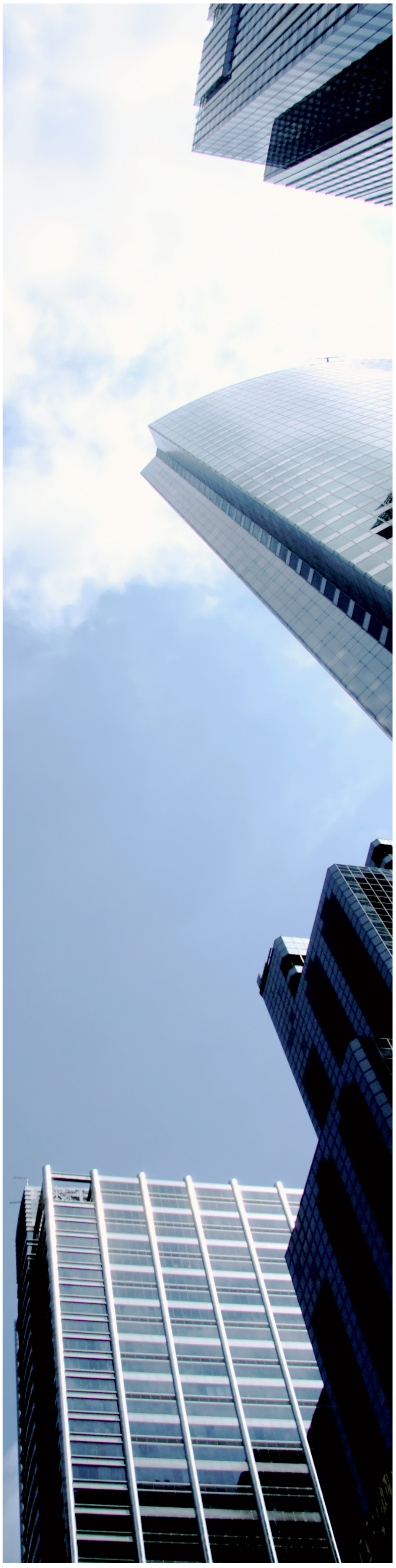
## July 2010 Highlights

OCX successfully introduced OCX.RiskMan, a risk control product for our OCX.BETS trading platform, which supports a marketplace for EFPs and block trades in OneChicago products.

More information on EFPs and OCX.BETS can be found on OneChicago.com

531,351 EFPs were traded, the highest monthly total in more than three years.

197,804 July futures valued at USD603 million were taken to delivery, consistent with the use of single stock futures as an equity finance product. The July futures represented 35 per cent of all existing open interest at that point and increased 4 per cent on the expiration day. **SLT**



# Planning for change

## Godfried De Vidts explains the key features of ICMA's new White Paper on the European repo market, and highlights the issues that need addressing.

**SLT** EXCLUSIVE

We are all very well aware that the financial markets are facing the dismantling of existing regulatory frameworks and the rebuilding of new frameworks at both national and international level. Against this background of swift and unprecedented regulatory change the European Repo Council of the International Capital Market Association (ICMA) has commissioned a white paper on the operation of the repo market.

Part of our intention was that it should be in some sense educational as we find that the role and function of the repo market in Europe is still in general not very well understood. There is concern that regulatory measures currently being considered in reference to other sectors of the market have potential negative and entirely unintended consequences for the functioning of the repo market. Any such disruption would be particularly unfortunate at a time when increasing demands are being made on repo financing in Europe, both by regulators themselves in terms of proposals for enhanced collateral management to reduce risk and by governments in terms of increased sovereign debt issuance.

The White Paper (available from the ICMA website www.icmagroup.org) was written by Richard Comotto of the ICMA Centre drawing on extensive interviews with market participants and clearing systems. The high level of support from the market for this project, from the ERC Committee and the ERC Operations Committee allowed the author to produce a detailed and comprehensive document on the issues and demonstrates the commitment of the repo community to contribute constructively to a meaningful debate to solve repo related issues.

The main issues which the ERC White Paper addresses are:

### Role and functioning of the repo market

The repo market is in many ways at the core of the financial system. It is pivotal to the functioning of markets and a cornerstone of stability. It provides secure and efficient cash funding and, as a means of borrowing securities, it underpins liquidity in the cash markets. The latest ICMA ERC European repo market survey, conducted in December 2009, estimates the size of the repo market in Europe, using the amounts of repo business outstanding on a single day in December 2009, is at least EUR5,500 billion.

Repo has achieved probably its greatest public visibility in recent years as a key tool in facilitating central bank operations, allowing them to implement monetary policy swiftly in normal market conditions and providing an established collateral management framework within which to act as lenders of last resort in times of severe market turbulence.

The repo market is particularly important to the functioning of an efficient primary market for debt securities. Primary dealers and other underwriters rely on the repo market to hedge the underwriting risk on both government and corporate debt, and to manage the new issue process efficiently. If this ability to distribute new issues was to be seriously constrained, undoubtedly the cost and risk of issuance would be increased and passed directly to issuers. Support for the primary market will become increasingly important over the next few years, given the quantity of debt which European governments, banks and corporates are expected to issue.

> Regulators now have an opportunity to take action to remove barriers to clearing and settlement in Europe, which may have contributed to the problems

In the secondary debt markets repo supports liquidity by allowing market makers to borrow issues for delivery to investors rather than having to hold them in inventory. Without this ability to cover temporary short positions, the provision of liquidity would be severely curtailed.

## Short selling and repo

In response to the Greek sovereign debt crisis regulators are discussing how to control short-selling and in particular 'naked' or uncovered short-selling. The repo market is implicated in that it provides the borrowing facilities that support short-selling. The suggestion is periodically made that all short-selling is intrinsically destabilising in that it allegedly (more than any other trading activity) exacerbates financial crises by amplifying price falls, fuelling volatility and causing settlement failures, thereby contributing to disorderly markets and threatening financial stability. However, studies in the equity market have shown that bans on short-selling have been followed by steeper price falls, increased volatility and wider bid-offer spreads. Short-selling plays an important role in price discovery and market efficiency.

Trying to prohibit naked uncovered short-selling (where a short sale of a security is made with no intention of borrowing to cover delivery) by requiring that borrowing should always precede short-selling mistakenly assumes that the relative timing of short-selling and short-covering is a reliable indicator of intent. Most uncovered short-selling is temporary or unintentional. A "pre-borrowing" regulation is not needed to address temporary uncovered short positions, as they are not a problem, nor is it a sensible way of addressing unintentional uncovered short positions. It would also impair market efficiency and liquidity. The White Paper notes that the market has adequate built-in mechanisms which penalise failure to delivery securities and therefore discourage naked short-selling in all but the most extreme circumstances.

As naked short-selling is a form of market abuse, it should be treated like any other instance of market abuse and dealt with by applying existing market abuse regulations.

Given how relatively little is known about the extent of short-selling in debt markets, the most prudent approach would be to start by monitoring short positions through confidential reporting to regulators.

## Clearing and settlement

Regulators now have an opportunity to take action to remove barriers to clearing and settlement in Europe, which may have contributed to the problems experienced during recent market turbulence. Interconnectivity barriers between national clearing and settlement depositories (CSDs) in various Eurozone countries and the international clearing and settlement depositories (ICSDs) used by international investors obstruct the efficient transfer of securities cross-border. Not only this, but fragmentation of European settlement imposes unnecessary costs and risks on European markets, obstructs market clearing and saps market liquidity to the detriment of issuers and investors. Despite considerable progress in removing the barriers to cross-border settlement in Europe, interconnectivity problems with the CSDs in Greece, Italy and Spain were highlighted by international market users and were exposed even more during the recent financial turbulence.

The view of the repo community in Europe is that the importance of the repo market to the efficiency and stability of the financial system is such that regulatory initiatives need to be carefully considered in order to avoid unintended damage, particularly given the greater reliance that will be placed on the repo market by regulators and governments in coming years. Proposals for regulatory action need to be based on a firm understanding of the operation of complex interactions within the markets as a whole.

*The full report is available on www.icmagroup.org and selected excerpts will be published by Securities Lending Times over forthcoming issues.*

**Godfried De Vidts is chair of the ICMA European Repo Council** SLT

# Brazil

## An exciting and growing market, that is attracting interest both globally and domestically, Brazil has a lot to offer. But it needs to ensure it's regulatory and taxation infrastructure is attractive to outsiders

**BEN WILKIE** REPORTS

It's holding the football World Cup in 2014 and the Olympics in 2016. It's been on the list of many of the most forward-thinking investors as a place to watch. Its economy is booming and its political clout is growing. No longer an emerging market, Brazil has staked its claim as a major player on the world stage. And funds are pouring in.

It's not all good news of course - the Bovespa has dropped by around four per cent this year, and while there's a long term confidence about the market, there are concerns from some investors. "The market ran ahead of itself and outperformed," said Mark Mobius, who heads up Templeton Asset Management. "It's a natural correction."

Growth, however, has been extremely positive. Market activity in 2009 was almost three times that of the year before, an admittedly quiet period globally, but in Brazil there was a drop of almost 80 per cent. The rebound, though, has been exceptional.

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."

## The players

In part, this is down to new participants entering the market. Long/short investment funds in Brazil are extremely popular, with several launching in recent months.

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."

"Santander has operated in Brazil for many decades and our customers respect the depth of our market knowledge," says a spokesman for the bank. "We are able to combine our local knowledge with the local knowledge we have of other markets, as well as a global outlook, so we can offer our clients the approach they need - whether that is local or international."

## Infrastructure

Brazil's securities lending industry is an operation in which the Brazilian Clearing and Depositary Company (CBLC) acts as counterparty and guarantees business. The securities lending programme - known as BTC - is accessed electronically. Any CBLC depository agent may put up shares for loan, from their own portfolios or from clients who have given express permission for the loan. Although pension funds are not major lenders, they are fully entitled to participate.

The BTC electronic access system, available on the CBLC services network, enables borrowers and lenders to consult the offers available and register the securities loan operations. Fees are negotiated separately between the borrower and lender, and loan contracts previously formalised between borrowers and lenders are also accepted. Any security listed on Bovespa is eligible for securities lending.

Borrowers must deposit a guarantee margin with the CBLC by way of a clearing agent. The margin is equal to the updated value of the securities plus a percentage defined by the BTC - based on a daily account of the liquidity and volatility of the securities. All fees and costs are debited from the borrower on the first day following the end of the loan operation.

Regulation for the securities lending market comes from the Brazilian Securities Commission, the CVM, and by the Brazilian Monetary Council, the CMN. There is no dedicated law on tax rules for the securities lending programme, but guidance is provided through an ordinance known as Instrucao Normativa RFB 742/2007.

Tax treatment depends on where the lender and borrower is resident or domiciled. If the lender or borrower is domiciled within Brazil, lending fees and interest income on cash collateral is taxed at 15 - 22.5 per cent depending on the period of the lending arrangement.

The tax for lenders and borrowers domiciled outside Brazil is slightly more complicated. The amount of tax payable depends on whether the territory in which the participant is based is classed by Brazilian law as a 'low tax jurisdiction'.

"The tax system is complicated and needs sorting out," says a spokesman for one international bank. "The costs of doing securities lending for international players in Brazil are high. And this is not because of the fees, or the charges levied by the CBLC. It's because they have to spend so much money on tax lawyers to ensure they have a full understanding of the business before they carry out any transactions."

## The future

Brazil is a shining light in the South American financial market. Domestic and international funds are making a real impact, and the securities lending market is booming, despite recent falls in the stock market. As the markets grow, more players are looking at opening or expanding their securities lending offerings, and Brazil is expected to become a major global player and a hub for the region. But the costs need to come down. **SLT**

### Investors' participation in loan stock market (by share)

| Lenders | Percentage | Borrowers | Percentage |
|---|---|---|---|
| Mutual fund | 33.71 | Mutual funds | 40.87 |
| Individuals | 28.1 | Foreign investors | 34.13 |
| Foreign investors | 25.8 | Others | 9.52 |
| Others | 7.06 | Individuals | 6.07 |
| Corporations | 3.89 | Commercial banks | 5.96 |
| Commercial banks | 0.84 | Corporations | 3.45 |
| Pension funds | 0.49 | Pension funds | 0 |

Source: Data Explorers

### Investors' participation in loan stock market (funds)

| Investors | Lenders | Lenders | Borrowers | Borrowers |
|---|---|---|---|---|
| | R$ Mi | % | R$ Mi | % |
| Individuals | 64,939.52 | 28.1 | 14,249.22 | 6.07 |
| Foreign investors | 59,621.15 | 25.8 | 80,110.35 | 34.13 |

# Bucking the trend

## Two years of reduced demand and short selling restrictions, where's the positivity, asks John Arnesen, senior business consultant at Data Explorers

**ANALYSIS**

With the exception of the annual dividend frenzy, most major equity asset classes have experienced a reduction in borrowing demand over the past two years so we looked for an asset class that appears to buck that trend.

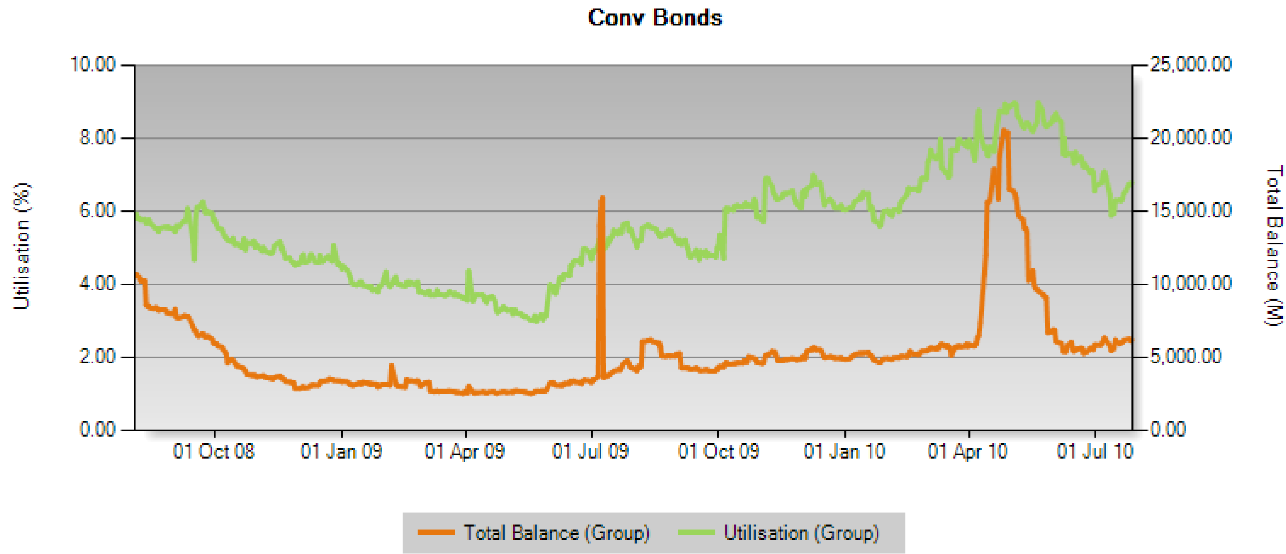
Demand to borrow convertible bonds has doubled over the past 12 months. It is off its highs but remains close to the levels last seen in 2008. A typical convertible bond arbitrageur buys the bond and shorts the equity so what is going on here?

As the chart shows, the Data Explorers measure of utilisation (demand as a percentage of supply) is 6.5 per cent having hit nine per cent in May of this year. That spike was driven by borrowing of Japanese convertibles with strongest demand in Softbank, Pioneer and Mitsui O.S.K Lines. The supply has remained static while the demand to borrow has been gradually increasing since July last year. To put this into perspective, the overall average bond utilisation is 19 per cent so it is a relatively low demand market, as one would expect.

Beneficial owners will welcome the fact that the basis point return to lendable assets, a measure of lending profitability, is currently a respectable 2.33bps with an average of 2.8bps over the past two years. The peak of 14bps was reached in late April. This is higher than the 2.1bps earned by lending corporate bonds although let's be clear, the corporate bond market has 32 times more on loan!

The weighted average basis point fee being charged by agent lenders varies from market to market but the two with the biggest availability - USD and EUR issues – are, as one would expect, the cheapest to borrow.

Demand to borrow convertible bonds is, in its simplest strategy no different from a classic short sale in that the perception that they are overvalued or rich will lead to shorting. After a surge in popularity as a place to invest in the second half of 2009 some felt they were overbought and short selling took off in the early part of this year largely driven by convertible bond arbitrage funds. This can partially explain the borrowing balance rising from USD6 billion to USD20 billion in April. The complexities however of the price movements and correlation of the component parts of a convertible can lead to a myriad of reasons to short it largely centered on the option or bond component being overpriced. This could lead to constructing the convertible using the bond and options market cheaper than buying it so traders become long the replication and short the actual convertible. **SLT**



## IMN's 15th Anniversary European Securities Lending Summit

Date: 20-21 September 2010
Location: London
Website: www.imn.org

In September 2009, more than 250 attendees and 60 beneficial owners participated in IMN's 14th Annual Beneficial Owner Securities Lending Summit. Leading European decision-makers discussed important issues confronting beneficial owners and the securities lending industry at large

## 4th Annual Collateral Management Conference

Date: 5-6 October
Location: Amsterdam
Website: www.jacobfleming.com

A number of high-profile defaults, volatility in the financial markets and heightened concerns over counterparty credit risk have placed great strain on many banks' collateral programmes and have highlighted the need for a new approach.

## Finadium 2010 Conference

Date: October 19 2010
Location: New York
Website: www.finadium.com/site/conference_1010.php

This event highlights best practices and emerging trends in the prime brokerage, securities finance and asset servicing industries.

The event features conversations with senior managers from leading industry participants, hedge funds and financial software providers as well as an overview of topics and data from Finadium's independent research reports.

# Industry Appointments

**Sean Duff** has joined as a director in the capital introduction group of Deutsche Bank, based in Chicago. Duff joins with 16 years of industry experience. Most recently, he was head of business development at Onex Credit Partners, and prior to that he worked at Merrill Lynch as director of business development for the company's hedge fund development and management group. Earlier in his career, Duff was director of alternative investments for SAC Capital Advisors

**Zachary Rubin** has also joined the bank as a director in Global Prime Finance Sales, based in New York. Rubin joins from Morgan Stanley, where he spent five years, most recently as an executive director in equity financing services. Prior to Morgan Stanley, he spent 11 years at Goldman Sachs as a convertibles trader.

Both Duff and Rubin report to Scott Carter, managing director and head of global prime finance sales and capital introduction in North America. "We are thrilled to welcome Sean and Zach to our market-leading team," said Carter. "Sean's deep industry experience will be an asset to our growing client base in the Midwest, and Zach's sales and trading experience will complement the team in New York as we continue to increase our client base on a global basis."

BNY Mellon has announced that **Curtis Arledge** will be joining the bank as vice chairman of the corporation and chief executive officer of BNY Mellon Asset Management.

Arledge was the chief investment officer for BlackRock's fundamental fixed income portfolios. He has also served as co-head of US fixed income at the firm and brings more than two decades of asset management and investment banking experience and leadership to BNY Mellon.

Mitchell Harris, who is serving as interim head of the asset management business, will continue in his role as chairman of BNY Mellon Asset Management's Fixed Income, Cash and Currency Group after Arledge joins the firm and will report to him.

Arledge will report to Robert P. Kelly, BNY Mellon's chairman and chief executive officer. It is expected that Arledge will join BNY Mellon in the fourth quarter of 2010. He will also have executive leadership responsibility for the company's wealth management business.

"We are delighted that Curtis is joining us at a time when our asset and wealth management franchise is growing, fueled by an unrelenting focus on investment performance and superb client service by our team worldwide," said Kelly. "Mitchell has played and continues to play a critical role in creating the momentum we enjoy today."

**Pamela Yuen** has joined Northern Trust as North Asian sales director for its Corporate & Institutional Services business unit. Based in the Hong Kong office, Yuen will be responsible for business development in Hong Kong, China, Taiwan and Korea. She comes to Northern Trust with more than 15 years experience in asset servicing, most recently as head of relationship management, Asia-Pacific for HSBC.

Yuen will report to Rohan Singh, head of asset servicing sales in Asia Pacific. "Pamela has an established track record in guiding institutional investors on global custody matters, as they increasingly allocate assets to foreign currency markets," Singh said. "With her experience in operations, relationship management and consulting in North Asia, Pamela will provide strong leadership for spearheading Northern Trust's continued growth and focus in developing the region."

BNY Mellon Corporate Trust has appointed **Richard P. Stanley** and **Debra A. Baker** to oversee its structured finance business lines, reporting to Scott Posner, CEO of BNY Mellon Corporate Trust.

Stanley, who has more than 25 years of experience in a diverse range of roles within the company, will be responsible for the growth and administration of structured finance for asset backed securities, mortgage backed securities, and collateral management, as well as the QSR and Asset Solutions business units. Prior to this appointment, he was head of Global Product Management for BNY Mellon Alternative Investment Services.

Baker, who also has more than 25 years of experience in senior product management, strategy, and risk management roles, will manage the collateral debt obligations business, including related ancillary products. She was previously the chief administrative officer for BNY Mellon Corporate Trust.

"Rick and Debra have extensive experience within the securities servicing industry and a deep understanding of the corporate trust business," said Posner. "Their leadership and strategic insight will add value to our structured credit business lines and enable us to enhance our servicing capabilities."

Daiwa Capital Markets has appointed **Chris Brown** as its deputy head of fixed income for Europe & the Middle East, a newly created role. In addition, the firm announced the appointment of Vince Purton as head of debt capital markets (DCM) for the region.

Dechert LLP has announced that **M. Holland West**, a leading private funds and derivatives lawyer, has joined the firm as a partner in the financial services practice group in the New York office. West was previously at Shearman & Sterling LLP, where he was the head of its global hedge fund, private equity, derivatives, and structured finance practices. He was also previously a partner at Cadwalader, Wickersham & Taft LLP, where he was the head of its asset management and derivatives practices, and an assistant general counsel at Goldman, Sachs & Co. advising its capital markets, derivatives, and commodity businesses.

"Holland's three decades of experience as a Wall Street lawyer adds to our already deep bench of talent in numerous financial services disciplines," Dechert chairman Barton J. Winokur said. "This is a historic time for the financial services industry, which is facing unprecedented changes, challenges, and opportunities. Holland's capabilities and background will be of great benefit to our clients as we assist them in adapting their businesses to the evolving structural and regulatory framework."

SLT SECURITIESLENDINGTIMES

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60 Second Resumé

# Sandra Fernandes

**Meet Sandra Fernandes, an experienced securities lending professional with the qualifications and industry knowledge to match**

## Tell me a little about yourself

Post university, I spent a year at The Republic National Bank of New York in its treasury department before joining The Bank of New York in 1991 in a similar capacity. I was asked to join securities lending after 18 months as part of a small team to help build the product given that it was relatively new in London at the time.

As the team and the product grew, I became instrumental in the set up and development of the operations area. I moved onto the trading desk in 1996 and by 1998 I was appointed head of the fixed income trading desk managing a team that later included the management of the reinvestment and equity trading desks.

During the merger with Mellon Financial Corporation, I was assigned the role of head of cash collateral reinvestment in London managing a book worth in excess of $70 billion.

## What industry qualifications or relevant certification do you hold?

I am an FSA registered representative and registered as CF30 with FSA.

## What was your last position in the industry and what did you enjoy most about it?

My last position at The Bank of New York Mellon was as manager of the cash collateral reinvestment desk overseeing the investment of over 200 segregated cash accounts and a money fund in short term interest rate products and money market instruments.

I most enjoyed directing and integrating new products and initiatives, liaising with clients in order to assess their needs alongside working with different areas of the bank in order to bring new projects and developments to fruition.

## What area are you looking to get back into?

I would like to move laterally within the industry where I can use my management skills and 16 years of securities lending experience. Given the events of the last three years I feel that internal compliance within a securities lending business needs to be more robust and I have spoken to a number of institutions on the subject who agree more needs to be done. A role that incorporates elements of this would be appealing to me.

## What do you feel you could bring to a future role?

I am flexible and proactive and a good communicator with extensive strategic thinking, relationship and project management expertise. I am extremely industrious, organised and determined and have a strong ability to successfully negotiate a number of business critical projects whilst consistently achieving revenue targets. I am very disciplined and conscientious and set high standards for myself constantly striving for excellence and efficiency. I feel I could bring all these attributes alongside my experience within the industry to a future role.

## What do you feel the industry needs most?

The need for greater transparency and to re-establish confidence with beneficial owners. The manner in which revenue is generated has changed since the stress experienced during the worst times of the liquidity crisis. A framework that ensures that risks and responsibilities are clearly understood is essential in continuing to attract new participants and in maintaining existing ones.


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