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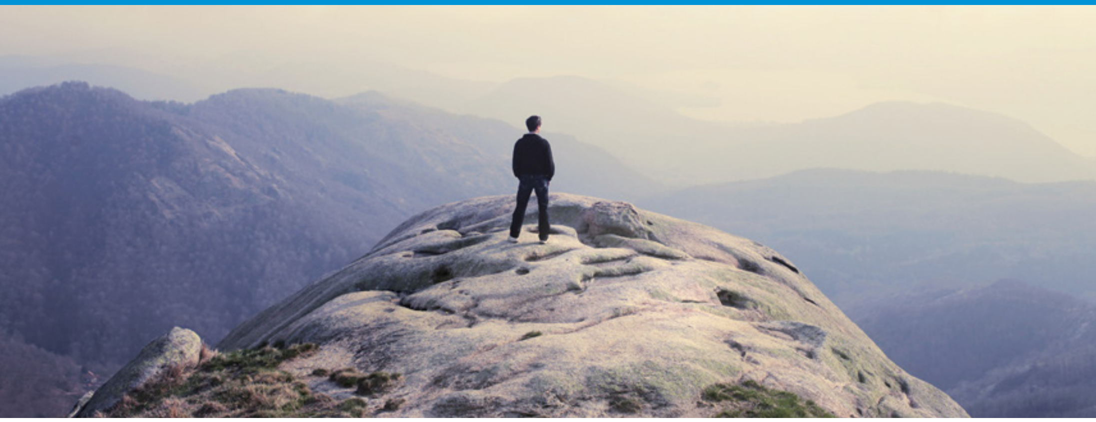

Spain and Greece react to market changes with short selling moves

MADRID 04.02.2013

Spain's financial markets regulator lifted its ban on short selling as its EU counterpart Greece extended its own ban for another three months.

Spanish regulator the CNMV extended an existing ban on short selling for an additional week in October 2012 and submitted a proposal to the European Securities and Markets Authority (ESMA) to impose a further three-month ban, effective from 1 November.

The additional seven-day ban was an extension of the CNMV's previous three-month suspension, which it introduced on 23 July 2012 to stabilise the volatility of the Spanish market.

Spain's short selling bans were in part due to the ongoing structuring process of the Spanish financial sector to cover capital needs.

The process, which was outlined in the 23 July MoU between the European Commission, the Kingdom of Spain and the Bank of Spain, was still underway at the time that the extension was requested, and uncertainties surrounded Spanish financial stability.

Spain has now lifted the short selling ban as the IBEX 35 Index rallies and the country's banks take steps to repair their balance sheets amid deep austerity measures.

Restrictions that expired on 31 January would not be extended, according to reports.

Greece's Hellenic Capital Market Commission (HCMC) has again decided to extend its ban on short selling for a further three months, effective from 1 February.

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SLTINBRIEF

A slew of feedback for the FSB

Seventy firms and associations have crafted replies to the FSB's 2012 consultative documents, which included an integrated set of policy recommendations, on strengthening oversight and regulation of shadow banking.

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Ernst & Young avoids Lehman Brothers action

The Financial Reporting Council (FRC) has decided that no action should be taken against Ernst & Young over the accounting firm's auditing of Lehman Brothers.

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Spain and Greece react to market changes with short selling moves

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The additional three-month ban is an extension of the HCMC's previous suspension, which it introduced in November 2012.

ESMA released its opinion on Greece's ban extension on 29 January. "There are adverse developments relating to the Greek banking sector which constitute a serious threat to financial stability and to market confidence in Greece."

"ESMA [also] considers that the duration of the measure is justified and appreciates the HCMC's statement in its notification of intent whereby the measure may be lifted during the period of enforcement of the measure, if appropriate," said a statement from the authority.

Short selling bans remain in other European countries, including Italy.

In the UK, the FSA temporarily suspended short selling of Sapiem SPA shares "following a significant downward price movement on 30 January 2013 and discussions with other competent authorities". ESMA is thought to be among them, although it declined to comment.

Shares in Europe's largest oil-services provider reportedly plunged 34 percent when it cut a forecast for 2013 profit on 30 January and an unnamed institutional investor bought approximately 10 million shares in the company on 29 January, leading Italian authorities to begin monitoring trading.

A statement from the FSA said: "The ban is effective, 31 January 2013 and will last for 24 hours. It restricts all short-selling transactions undertaken by any person irrespective of their country of residence on all UK trading venues. This measure shall not be subject to any exceptions including for market makers."

A slew of feedback for the FSB

Continued from page 1

The FSB's 13 recommendations to address shadow banking risks in securities lending and repos are of particular importance to the industry, as they look to enhance transparency, strengthen regulation of securities financing transactions, and improve market structure.

Banks including Deutsche Bank and the Central Bank of Ireland, asset management firms such as BlackRock, BVI and Amundi, and associations such as the Risk Management Association (RMA) and the Canadian Bankers Association, wrote detailed recommendations on the proposed policies.

Replies universally stressed that securities financing markets are an essential component of the financial markets as a whole and regulatory interventions in this space need to be advanced carefully.

Many centred on scope and overlap, especially in light of work by the Basel Committee to strengthen liquidity and ensure prudent balance sheet risk management.

Most were agreed that transparency was a prudent concern of the FSB, but warned that again, overlap would have to be taken into account with any policy updates.

In its letter to the FSB, the RMA said that the securities finance industry is the subject of significant legislation in the US and Europe already, with regulations such as Dodd-Frank and Basel III, and suggested that the board integrate its recommendations with these, rather than "recommend changes that would impose additional burdens on agency securities lending activities".

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

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

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

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

The full list of replies is available at www.financialstabilityboard.org/publications

Ernst & Young avoids Lehman Brothers action

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After Lehman Brothers failed in September 2008, its administrators identified a "significant shortfall in the pool of money held on trust for clients".

The bank did not properly segregate and safeguard client money as specified by the Financial Services Authority's Client Assets Sourcebook (CASS), and the FRC's accountancy and actuarial disciplinary board was also concerned that money relating to Lehman Brothers's prime brokerage, or major wholesale clients, needed segregation.

In turn it was alleged that Ernst & Young was not severe enough on the bank, and that it signed off auditing reports on Lehman Brothers's European arm despite its improper segregation of client money.

In October of last year, Lehman Brothers's prime brokerage customers were paid in full following an agreement between the bankrupt investment bank and its European arm.

"Following the conclusion of the investigation, the FRC's executive counsel, Gareth Rees, has decided that no action should be taken against Ernst & Young or any individuals in connection with their conduct in this matter," said an FRC statement on 29 January.

"[The] executive counsel has decided that there is no realistic prospect that a tribunal would make an adverse finding against Ernst & Young in the UK or members within that firm. The investigation will therefore be closed and no further action taken."

Markit adopts Selerity's dividend event data

Markit plans to integrate Selerity's dividend event data into its dividend product platform.

Selerity is a provider of real-time event data solutions for the financial services industry. Its platform will be used to identify key dividend announcements from US companies in real-time, allowing them to update their dividend forecasts as new information enters the market.

Markit will also integrate Selerity's real-time US dividend feed to generate intraday alerts automatically on a 45 minute delayed basis. Alerts will include changes to the US companies' dividend amount, ex-dividend date, record date and payable date.

Rob Jaeger, managing director of equities at Markit, said: "We are pleased to offer our customers access to Selerity's market leading low-latency news offering which will allow us to deliver a more timely dividend forecasting service."

Ryan Terpstra, founder and CEO of Selerity, added: "We are thrilled Markit has selected Selerity's dividend event data offering, which is a testament to the quality of our product platform."

ForexClear reaches $500 billion notional cleared

LCH.Clearnet has cleared more than $500 billion in notional of FX non-deliverable forwards through its ForexClear service since it launched in March 2012. The volumes were driven by figures of $207 billion in Q4.

ForexClear—which was created in collaboration with FX market participants and global regulators—has been driven by demand for clearing solutions as FX market participants seek to manage their counterparty risk exposures.

Gavin Wells, CEO of ForexClear, said: "The strong growth in volumes cleared through ForexClear indicates that FX participants have full confidence in our offering and we are very proud of the outstanding progress made since launch just 11 months ago."

"Furthermore, we remain fully committed to supporting the ambitions of global regulators, as demonstrated by our timely delivery of reliable and comprehensive FX data reporting."

Exclusives are the bright spark amid cowed volumes

Client auctions in 2012 represented some of the highest revenue generating auctions in the firm's history, said eSecLending.

The firm's co-CEO Chris Jaynes said: "We are thrilled with the strong bids received for the

2013 dividend season. The breadth of borrower participation, demand for exclusives and overall outperformance against market benchmarks have all increased over the last year."

"Specific bright spots include US small-caps, Asia Pacific equities, high yield bonds and European yield enhancement. As a result, our clients have experienced material year-over-year increases in revenues."

Jon Ottomanelli, managing director and head of securities lending at Citi, a borrower in the auctions, said that committed supply through exclusives continues to be an important component of its overall strategy.

"In order to best service our hedge fund clients, it is very important for us to augment our supply with high quality assets. In this regard, eSecLending's auction process helps us achieve our goals in a transparent and efficient manner."

Agent lenders feel uncertainty over indemnification

Strong institutional participation, stabilised fee splits and concern over indemnification were just three of the trends that Finadium identified in its recent securities lending survey.

"Institutional investors have become more comfortable with their securities lending programmes as risk is managed closely, minimum spreads have been mandated and the market appears less frothy than it once was," said the report.

"We are now past the days when many institutions sought to end or pause their securities lending activities; now rather large institutions appreciate the steady, albeit reduced, revenue stream that lending generates, while smaller funds may have ended their programmes due to low demand. Unless indemnification creates significant change, we expect that most large and mid-sized institutional investors will stay in securities lending and continue to earn a reduced but predictable revenue stream."

The report added that large institutions are surprised that their agent lenders have not had more conversations with them on the topic of indemnification.

"Several executives said that they had heard about potential changes due to capital charges and have asked questions about it, but have a hard time getting a straight answer about the impact on future costs. This is a legitimate question but also a legitimate response from agent lenders; there are still a host of uncertainties to consider in the lending business."

Chilean brokerage Banchile builds for the future

Banchile, Chile's third largest brokerage house, has selected Fidessa's Latin American sell-side trading platform to underpin its institutional trading activity.

Jose Antonio Diaz, chief investment officer at Banchile, said: "Through Fidessa's trading platform, we are leveraging the most sophisticated and robust trading technology used by market participants across the globe."

"This enables us to offer world-class service to our growing institutional client base. Fidessa's in-depth knowledge of the region is evident and this, coupled with its strong reputation for delivery and support services, drove our decision to partner with them."

Alice Botis, head of business development for Fidessa in Latin America, added: "We are delighted to add Banchile to our growing Latin

American client base, demonstrating the strong demand for Fidessa solutions by domestic and international market participants.

"We are seeing a lot of activity in the Andean region with firms replacing legacy vendor and proprietary systems and investing in customisable, high-throughput, low-latency trading solutions to enable high-quality execution, greater operating efficiency and a solid basis for growth."

Eurex Repo to fund GC Pooling and Euro Repo markets

Eurex Repo will extend the maximum term of tradeable securities for the Eurex Repo markets such as GC Pooling and Euro Repo.

Currently, the maximum duration for transaction is one year. As of 21 January, customers could also trade terms of up to two years.

With this step, Eurex Repo provides its market participants with a new and easy-to-use opportunity to make use of the repayment option of the long term refinancing operations (LTRO) of the European Central Bank (ECB).

Starting on 30 January, the ECB began allowing banks to prematurely return LTRO liquidity that they borrowed from it in December 2011 and February 2012 with a maturity of three years.

The fixed rate for the ECB loan is significantly higher than the current interest rate in the market.

"In close coordination with our participants, we have realised this innovative extension within a short time frame. It is a reflection of market demand and will help banks to re-allocate their funding necessities to a cost-sensitive, secure and efficient alternative like our GC Pooling market," said Marcel Naas, managing director of Eurex Repo.

The market consultation revealed that the current liquidity situation that is expressed by a flat yield curve shifts market activity significantly into longer terms in the OTC markets, especially into terms over one year, he added.

Swedish bonds are safest in the world, says ING

For default risks, ING Investment Management has judged the Swedish government bond market to be the safest bond market in the world, predicting Sweden will keep its safe haven status for the foreseeable future.

After 10 years of data analysis using its proprietary scoring matrix, ING Investment Management found that in all but one year, Sweden ranked first in the world when looking at sovereign credit risk factors such as solvency risk and external dependency, as well as environmental, social and governance issues in order to gauge both the ability—but also the willingness—to service debt.

Thede Ruest, fund manager at ING Investment Management, said: "The top three spots have consistently been taken by the Nordics—Sweden, Denmark and Finland—making it the bond market's credit safest region in the world in the last decade."

"Sweden's debt-to-GDP ratio stands below 40 percent and is one of the lowest in the world.

The country is amongst the few high-income countries that in its recent past have been able to generate government surpluses."

Ruest added that Sweden's external dependency is "very low due to its large and sustained current account surpluses—most recently at around 7 percent of total GDP."

"Sweden, unlike members of the European Monetary Zone, has its own country specific policy framework (fiscal, monetary and macro prudential) and its 'own' currency—the Swedish krona—that allows for substantial flexibility to control funding costs."

ING Investment Management stated that it does not imply that the Swedish government bond market is entirely risk free, citing high household leverage as the key risk to the financial sector.

The Salvation Army versus BNY Mellon continues

A judge has refused to throw out a lawsuit from The Salvation Army that claims BNY Mellon mismanaged its assets by investing the collateral used for securities lending in risky mortgage-backed securities.

In April 2011, the Southern Division of The Salvation Army in the US launched legal proceedings against BNY Mellon following losses that were incurred as a result of its securities lending programme.

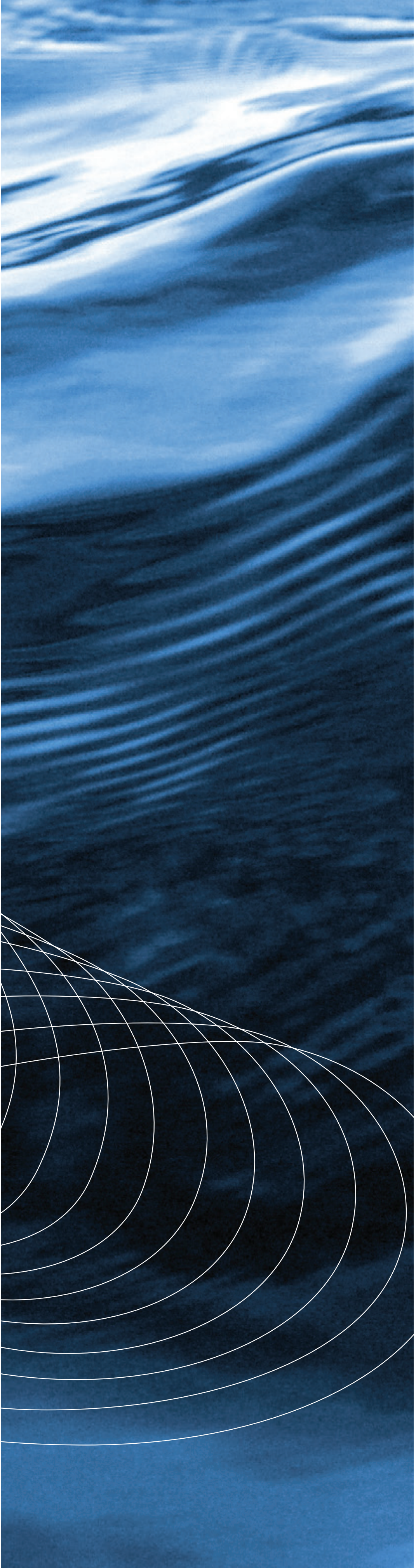
The charity alleges that it had emphasised to the bank that it had little experience in securities lending and wanted little or no risk from participating.

"As a result of BNY Mellon's misconduct, The Salvation Army has incurred losses and is left holding unproductive, toxic assets with extended maturity dates, the values of which have substantially declined," the organisation said in the lawsuit.

"We believe our actions were appropriate, and we will defend ourselves vigorously against these claims, which are without merit," said Ron Gruendl, a spokesman for BNY Mellon, at the time the lawsuit was filed. "We have a very rigorous process, and our clients understand both the benefits and risks of securities lending."

Justice Barbara Kapnick said that the charity must only "state a claim at this juncture, not prove it" in a 25 January decision rejecting the bank's motion to dismiss the breach of fiduciary duty claim.

Kapnick also let breach of contract and gross negligence claims stand, but dismissed a claim for negligent misrepresentation. "We are pleased that the court's procedural decision narrowed the case, dismissing one of the claims against BNY Mellon," said a statement from the bank. "As the litigation proceeds, we're confident the facts will demonstrate that the remaining claims are also without merit."



Absolute regulation disrupts absolutely

The IMN Beneficial Owners' International Securities Lending Conference had to compete with Mardi Gras and the Super Bowl for its attendees' attention

MARK DUGDALE REPORTS

The IMN Beneficial Owners' International Securities Lending Conference in New Orleans kicked off with a panel on the five issues that beneficial owners need to focus on in the current regulatory and economic climate.

Regulation dominated the panel's update for beneficial owners—and the conference overall—with Mark Payson of Brown Brothers Harriman saying that securities finance is in "pretty good shape", but regulations are negatively affecting the financial services industry as a whole.

Paul Wilson of J.P. Morgan pointed to Basel III capital requirements and Rule 165(e) of the US Dodd-Frank Act as particular concerns for beneficial owners. He said that indemnification could look very different if the rules go through as they currently stand. Bill Kelly of BNY Mellon agreed, saying that "the cost of this service is only going to increase".

But Jason Peter Strofs of BlackRock was more positive. He said that the relevant regulators are receiving lots of feedback and "seem to be listening. He is "pretty optimistic that the rules will change".

A panel highlighting specific regulations followed, and the US SEC, Financial Industry Regulatory Authority and Federal Reserve Bank of New York were all represented, although disclaimers made it clear that the panel members' views were their own.

Explaining where her agency is coming from when it looks at securities finance, Theresa Hajost said that the US SEC is a market regulator that cares most about investor protection, rather than systemic risk, which is the mandate of the Financial Stability Board (FSB).

She said that "people are very concerned about the consistency of regulations". Indeed, her agency is keen to avoid creating regulatory arbitrage opportunities.

When securities lending was first practiced, definitive agreements between counterparties that are common today were not used, according to a panel of experts looking at the practical applications of regulations.

Moderator Tim D'Arcy of SunGard Astec Analytics used this to stress that the industry should not be afraid of new regulations. "We shouldn't look at regulation as a negative or as the end of the world as we know it."

The panel took an in-depth look at the industry's drive towards greater transparency, with Anita Ryan of eSecLending saying: "We've come so far with transparency as an industry, but more regulation is coming."

Ryan pointed to the US SEC's mandate to encourage more transparency in the industry and the FSB's proposals, which include the possibility of using surveys and trade repositories to make markets less opaque, as evidence to back up her prediction.

The FSB in particular wants a host of data sets, including the amount on loan, asset class, and the number of custodians used, to be reported in a bid to make the securities finance industry more transparent.

Anthony Toscano of Deutsche Bank said that his firm already shows all of the FSB's desired data sets, but D'Arcy stressed caution, saying: "Don't always think more is better."

He said that beneficial owners do not need to insist on receiving daily reports with all of this information from their agent lenders if they look at or use it once a month.

A panel of representatives from prominent beneficial owners, including the State of Louisiana Department of the Treasury and Franklin Templeton, looked at how to earn revenue in a risk-adjusted fashion.

John Broussard of the State of Louisiana Department of the Treasury said that an important lesson to be learned from the financial crisis of 2008 is that markets are changing—quickly and constantly—and they need to look at different ways to earn revenue as a result.

"It is inconceivable that you can just stick your head in the sand and say this is what we're always going to do and we're never going to do anything different. Even for [a beneficial owner] as conservative as we are and as historically tied to one programme as we are, [we need] to test the waters elsewhere to see if what we're doing is right for us and whether there's anything better out there."

"It's inconceivable that I could sit here and say we're just going to do it one way from now on, and I don't think anybody could say that. I think the game is changing constantly and it's changing quicker now than it ever has."

Cash reinvestment came under the microscope in another panel. Markit Securities Finance's David Carruthers said that there is a preponderance of non-cash in US-domiciled funds, and this trend is likely to continue.

While cash remains king, it is important that market players practice collateral flexibility, because it is "good for the health of your programme", said Carruthers. **SLT**

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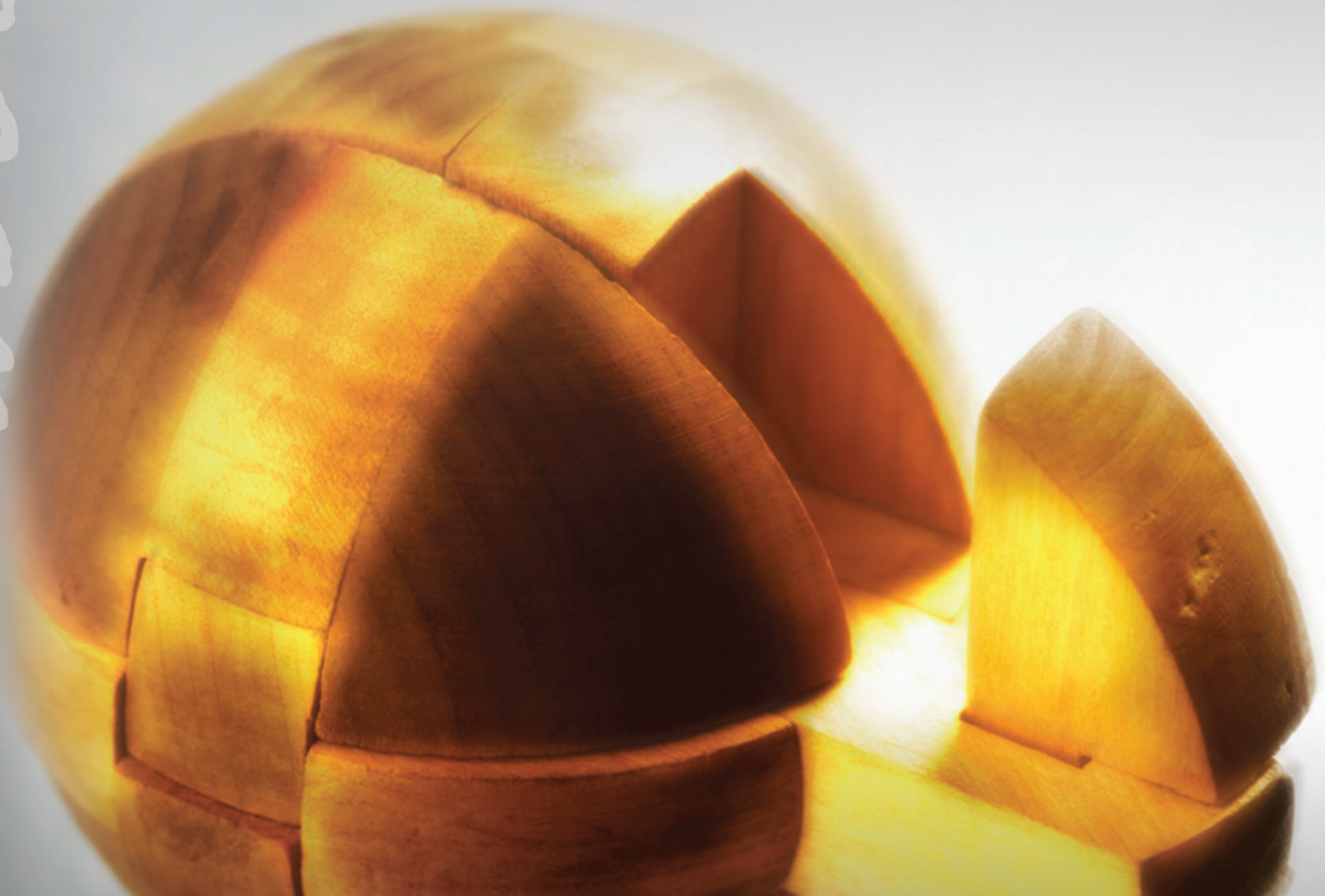


Don’t go: time to say good-bye to indemnification?

The old practice of indemnifying a beneficial owner against the possibility of a borrower default could be under threat when Basel III restrictions come into force. SLT takes a look

GEORGINA LAVERS REPORTS

There was a spot of good cheer amidst the usual January blues, as chief central bankers in Europe quietly eased up restrictions of Basel III. The regulation which is intended to increase the amount and quality of capital that is held on balance sheets, was amended to the benefit of financial institutions: the liquidity deadline was pushed back four years, and new rules broadened the range of allowable corporate debt.

The demands on agent lenders and other players in the lending market could be favourable. Increased banking costs would result in greater demand for highly rated assets, which means in turn that their financing costs via the repo market would increase, and the funding cost for issuers for such assets would decrease.

The racking up of eligibility could mean a clear source of revenue for custodians, as value is added to the assets that lenders are holding but not using much at the moment. Every security that is eligible as high-quality liquid assets will be in demand to cover activity, including AA- or above rated corporate bonds.

Along with expectations for future demand, indemnification is another uncertain aspect of securities lending for institutions. On 12 June 2012, US banking regulators released three joint notices of proposed rulemaking (Capital NPRs) containing proposals to implement the international capital standards of Basel III, as well as a final joint market risk capital rule implementing the international standards that are referred to as ‘Basel II.5’, each in a manner aligning with Dodd-Frank Act requirements such as the Collins Amendment. Many believed that the changes to the capital regime would increase capital costs that are associated with providing borrower default indemnifications.

“It remains uncertain as to how borrower default indemnifications will be treated for purposes of calculating a bank’s leverage ratio,” stated a BNY Mellon Q3 2012 report. “The Capital NPRs added a new supplemental leverage ratio to address off-balance sheet items but specifically excluded securities finance transactions. US banking regulators indicated that they would address securities lending indemnification at a later date once there is international consensus. Depending on the methodology ultimately selected, inclusion of off-balance sheet indemnifications in the leverage ratio could severely limit agent banks’ ability to provide this protection.”

For many years, beneficial owners, ranging from mutual funds to both public and private pension plans, have relied on bank securities lending agents to enable them to obtain incremental revenue from their securities holdings in a safe manner. To provide additional comfort as to the safety of the transactions and to demonstrate confidence in their risk management systems, banks have long provided borrower default indemnification as part of their securities lending services: an easy price to pay, given that this kind of insurance is rarely used.

But Basel III will require a lending programme to have borrower indemnification to move on balance sheets, leading banks to ponder over whether to take any additional capital charges on the chin, or pass the buck onto clients by using lower fee splits.

“New Basel III requirements are intended to create a capital charge for indemnification, but this has not served to relieve any lingering concerns that beneficial owners might have,” said a May 2012 Finadium report, The Future of Indemnification in Securities Lending.

“The costs of indemnification are mounting, and agent lenders may not have the flexibility to offer this service to every beneficial owner in the future.”

“The challenge comes in managing leverage ratios and liquidity coverage ratios, each of which require calculating a bank’s entire liabilities, including those made as a guarantee or promise. Under Basel III, indemnification is a balance sheet cost; a bank’s potential liability to a client’s portfolio must be calculated and that figure included as part of the bank’s liabilities or potential cash outlay over the next thirty days. As banks are eager to manage their risk capital ratios for the greatest benefit, the return provided by indemnification may be too expensive to bear.”

Basel III, as reflected in the Capital NPRs, places particular emphasis on activities resulting in counterparty credit risk, including securities finance, and contains several changes that specifically affect indemnified agency lending programmes.

The Capital NPRs, like Basel III, include both a generally applicable “standardised” method to calculate risk-weighted capital as well as an “advanced approach” that is applicable to the largest or most internationally active institutions (including the major US agent banks), according to BNY Mellon’s report.

However, the Collins Amendment, as implemented in the Capital NPRs, requires the largest institutions to calculate capital charges under both the standardised and the advanced approach, using the higher of the two as the applicable capital charge.

“Although, the determination of which method is controlling is done on an aggregate basis, it appears that the method that would produce the largest capital charge for indemnified securities lending transactions would be the charge calculated under the ‘standardised’ method.”

The standardised method uses a collateral haircut approach, as “opposed to the simple VaR or other internal models that would reflect correlations,” said BNY Mellon’s report.

“The standardised approach also would, to some extent, negate the value of netting arrangements. These changes increase the denominator in the required regulatory capital ratios and thereby will significantly increase capital required to provide borrower default indemnification.”

However controversial Basel III may appear, it seems as though mid-size and large lenders will continue to appreciate a steady (if condensed) revenue stream. And as for indemnification, both large institutions and their agent lenders must wait it out for any kind of meaningful conclusion. **SLT**

Tweaks that speak

Citi may have confidence in India's burgeoning securities borrowing and lending market, but the country has some changes to make, as SLT finds out

GEORGINA LAVERS REPORTS

More than 15 years have passed since securities lending and borrowing became doable in India. The Securities and Exchange Board of India (SEBI) first permitted transactions as early as 1997, via authorised intermediaries, with a range of financial instruments including cash, bank guarantees, government securities and other registered securities.

But permission to lend and borrow does not necessarily mean that actual business is carried out, with India's rules very much geared towards reducing the risk of settlement failures for domestics.

The current framework was first introduced in 2007, with a view to provide a mechanism for investors to participate in covered short selling, by borrowing securities to enable settlement of the short sold securities.

"Securities borrowing and lending in India is an exchange-traded model with orders executed on an anonymous basis; screen-based order matching platforms are provided by approved clearing corporations/clearinghouses of stock exchanges which are registered with SEBI for this purpose.

"Currently, NSCCL and BOISL are approved to offer this product," says Pierre Mengal, Asia Pacific head of securities finance at Citi Transaction Services.

SEBI has continuously tried to relax rules around the market, evolving its model over three phases: an initial launch in April 2008 where lending/borrowing contracts were restricted to seven days tenor; December 2008, when tenor extended to 30 days and margin requirement for borrowers reduced with flexibility in collateral form; and July 2010, when tenor extended to one year, with the feature of early recall (for lenders) and early repay (for borrowers) introduced.

Two thousand and ten proved eventful when it came to igniting the market, with Mengal pointing out that since then, average monthly traded volumes have grown multi-fold. "From turnover levels which were insignificant in July 2010, they grew significantly in the first year. Since August 2011, the market has continued to grow at a rapid pace. This clearly demonstrates investor interest and uptake of this product."

As the first and only international custodian bank to offer securities lending services on the National Stock Exchange in India, Citi has needed to be proactive with exchanges and regulators on securities borrowing and lending right from inception. "Citi has been closely involved in the overall contract structure, providing feedback to address investors' needs, etc. Some of our key recent initiatives include discussions with the Reserve Bank of India around short selling period and foreign ownership limits and changes to the treatment for corporate action," says Mengal.

Citi's service, which gives its domestic and offshore clients access to the exchange-traded central counterparty model in the country, has the advantage of being the first global custodian to cross the finishing line, with the caveat of having no template for adapting an international securities lending solution to the exchange traded framework in India. Now that the bank has made the first steps into the country, Mengal expects other custodians to follow in its wake.

Though November 2012 saw another relaxation of lending and borrowing guidelines, critics argue that the new and improved rules will not stir up the market, with the biggest problem being tough margins.

SEBI allowed lenders and borrowers to carry forward their positions for up to three months rather than one, but brokers at the time were reported as saying that a market for stock lending and borrowing would be more effective outside of the stock exchange settlement system in an OTC format.

But Mengal argues that the exchange-traded model uses clearing corporations with robust risk management systems and employs a time-tested margining mechanism.

"While there is a demand from some market participants for a parallel OTC model, the current central counterparty model in India has emerged as a viable alternative which is working well."

As well as the system may work for local participants, foreign interest is low. "Considering the total asset pool of foreign institutional investors (FIIs) estimated at approximately $180 billion, the current participation of FIIs as lenders is very small as compared to the traditional international ratios of lendable assets/actual loans and is bound to grow and deepen further," states Mengal.

He adds that lenders of Indian securities are seeing average annualised returns of 600 to 1000 basis points, surpassing Taiwan (400) and Hong Kong (200).

"Given the high returns, we are seeing an increased interest from offshore players to participate as lenders in this market."

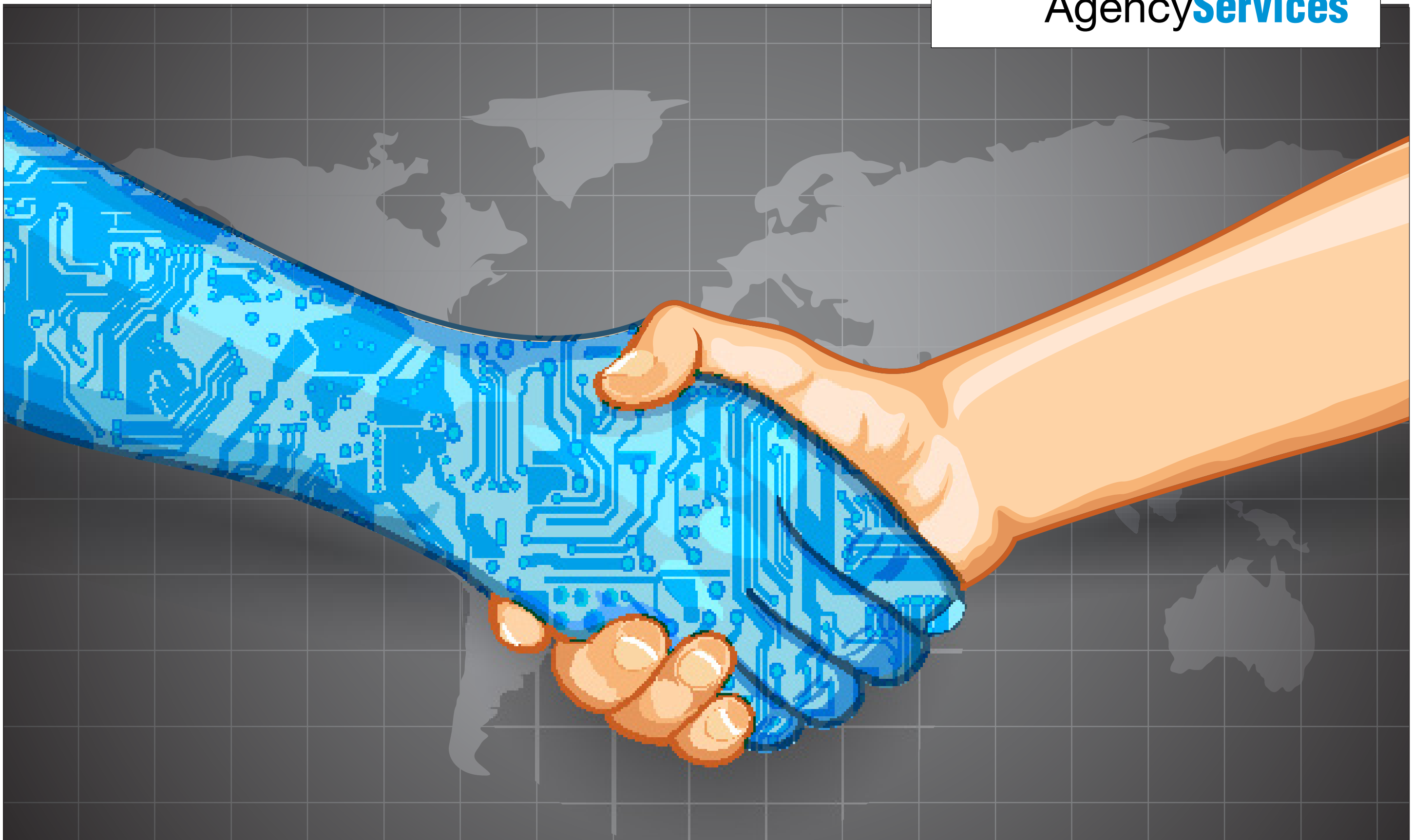
Mengal admits that there has traditionally been a shortage of lenders—and therefore supply—in the market. But he is confident that changes in insurance regulation will change this. "Insurance companies, which hold significant proportions of equity assets, are currently not permitted to lend securities and to participate in securities lending. However the insurance regulator has recently issued draft guidelines to permit insurance companies to participate as lenders in this market. This will be a key change."

While there is a demand from some market participants for a parallel OTC model, the current central counterparty model in India has emerged as a viable alternative which is working well

On the borrowing side, Mengal says that he continues to see active interest from FII borrowers (broker-dealers and hedge funds), which are keen to participate. One of the key constraints for them is the high cost of collateral, as they can only place collateral in Indian rupee cash. "If such players were permitted to place non-cash collateral like government securities (as is allowed for them in cash equity and derivatives segments), it would go a long way towards increasing their participation. The other factor is that currently securities borrowing and lending is permitted only in stocks which have underlying equity derivatives. If the permissible list was expanded to include other stocks, it would increase the demand in the segment."

"Finally, across institutional lenders and borrowers, investor awareness has been a factor impacting participation," remarks Mengal. "This is especially true given the fact that the India securities borrowing and lending model is different from most other markets. Lenders/borrowers need to be familiarised with the nuances of this market and as the awareness increases, we expect more participation on this segment."

Though SEBI has made changes to address shorter tenors and the inability of lenders to recall stock that is lent, it looks as though the country has a long way to go before it can make a real dent in the market. But with Citi placing confidence in the region, as well as upcoming insurance regulation, it would be remiss to discount India just yet. **SLT**



Anywhere, anytime: sell-side partnerships

Guy Knepper explains the effects of ESMA guidelines and why the location of a desk is irrelevant, so long as the service is good

GEORGINA LAVERS REPORTS

Is it fairly easy to capture the market, simply due to the fact that not many firms offer securities lending services in Luxembourg?

CACEIS has its dealing room and securities lending desk based in Luxembourg, but the dealing room services are available to clients of the entire CACEIS group. The securities lending market is a global market and the location of a securities lending desk has little bearing on the ability to service clients, other than effects of time zone coverage and the regulatory environment. Luxembourg is able to cover much of US, European and Asian needs in terms of business hours, and the country has an enviable reputation for social and economic stability, a business-friendly government and quick action when it comes to implementing directives into national law.

As CACEIS is a multi-faceted asset servicing provider, active throughout the world, and occupying a position as Europe's leading custodian, most of our clients join as custody clients and then benefit from our integrated securities lending programme, which often not only offsets custody fees, but also contributes to the 'net' fee income, boosting the performance of the fund. In the past, we only offered our securities lending services to our custody clients. However, due to increasing demand, CACEIS has set-up a remote lending offer in order to meet potential external client needs.

One peculiarity of Luxembourg's regulation is the level of collateralisation that is required to protect securities lending transactions—do you take advantage of this quirk?

Although the Luxembourg regulations stipulate that the minimum is set at 90 percent of the global valuation of the securities lent, CACEIS always collateralises at 105 percent. We are servicing a conservative clientele that is unwilling to take unnecessary risk on its assets and carefully scrutinises counterparty risk, so we make asset security a priority and take measures to limit counterparty risk. This position is unlikely to change in the near future.

Do you think the country will grow in terms of securities lending or is it destined to be an administrative hub forever?

Luxembourg definitely has a specialisation on the administrative side, mainly for mutual funds but also to a growing extent for alternative investment funds. It looks like its future in this respect is fairly stable. The future for securities lending in the country largely depends on where the lender decides to set up its dealing desk. CACEIS decided to locate its securities lending operations in Luxembourg, which is the hub for the group's international business and serves all of our entities. Luxembourg provides a stable regulatory environment from which to run a lending programme, but with today's electronic communication tool and IT platforms, the actual location of the desk is less important than the quality of the service, the integration with custody and fund administration, the ability to manage risk, and the overall reputation the lending desk.

Are you seeing increased demand for independent collateral management services?

Currently, there is little demand for independent collateral management services from our clients as we offer a full service package through a one-stop-shop approach, which covers the entire lending process with a clear respect of task segregation and properly defined 'Chinese walls'. We have also seen very little demand for this from third-party clients.

What do you think of the state of transparency around collateral metrics in Luxembourg? Has it improved over the last couple of years?

It is very difficult to give an objective opinion on collateral metrics as there are no statistics available on the subject. In Luxembourg, lenders currently have no obligation to publish statistics, so we have little idea as to what the clients of competitors are applying as collateral metrics. However, we believe that with the ongoing changes in regulation, this will very likely change in the future as part of the regulators efforts to shed more light on securities lending in general and collateral applications in particular.

What do you think of ESMA's July guidelines on ETFs and other UCITS issues that could affect securities lending profits?

CACEIS clearly views the European Securities Market Authority's (ESMA's) guidelines relating to securities lending profits as a means to improve and to strengthen transparency, but also to gain a better understanding of the value chain—who is taking a share of the revenues and for what reason. For CACEIS, it has has little impact as there is nothing in the guidelines that precludes a securities lending agent (such as a custodian bank or fund manager) from charging a commercial fee for its services. A commercial fee is a cost that the guidelines state can be deducted from the revenue.

The main aim of the guidelines is in fact to allow only active players in the value chain to take a share of the revenue. Services that are provided by a lending agent such as CACEIS include the negotiation of loans, record keeping, corporate action monitoring, income collection and collateral risk management, so providing a justification for a share of the revenue is not hard. What the guidelines aim to achieve is, for example, to prevent a fund sponsor from simply delegating the securities lending operations to a third party and taking an 80 percent share of the revenue without having to do anything. ESMA judges that—in this type of case—the risks are all borne by the investor, but revenue is received by the manager.

However, even for the manager/promoter, this will only have a minimal impact. When appointing a custodian to support their securities lending operations, they may charge an additional fee that is designed to cover the expenses and costs that are associated with the administration and oversight of the lending programme. **SLT**

Guy Knepper
Head of securities lending
CACEIS Group

euroclear

Post-trade made easy

Get on the Collateral Highway

Whatever your collateral destination

The right securities – at the right place – at the right time

Short sellers slash bets on French stocks

What is driving positive sentiment towards the county's equities? Alex Brog, director at Markit Securities Finance, takes a look

GDP outlook is bleaker than the rest of Europe yet the major index has powered ahead. Short sellers have been covering positions for some time, exchange-traded products (ETPs) have seen net outflows, relative skew has increased and corporates are cautiously optimistic towards dividend payouts.

The French economy looked set to contract in Q4 of last year and the flash PMI indicated an acceleration in the rate of decline in January, according to Markit's chief economist, Chris Williamson.

This contrasts with an easing in the rate of decline across the eurozone as a whole, led by strengthening growth in Germany.

The Markit PMIs show a consistently negative trend in recent months, slumping to just above 42 by year end, the lowest reading since 2009 and was 44.6 in December and 42.9 in January.

Recent equity gains have been largely based on signs of the debt crisis easing and increasingly aggressive central bank action around the world.

"The data for the real economy now need to improve for investors to feel comfortable with these higher valuations," adds Williamson.

The surge in equities markets around the world has resulted in widespread short covering as short sellers have been loath to bet against rising markets.

This trend is particularly pronounced in France where the rate of decline in average short interest has been considerably steeper than that observed across the European index.

Average short interest in the CAC 40 Index has almost halved over the past six months from the high of just under 6 percent in early July to 2.7 percent today. Whereas the average rate of decline across the Stoxx 600 index has been more gradual, falling from 3 to 2.3 percent.

There remains several highly shorted shares in the CAC 40 index, with advertising firm Publicis topping the list with 10.2 percent of its total shares on loan. The company recently appointed a new finance director and creative director as well as completing the acquisition of independent digital marketing agency LBi for €416 million.

Bouygues, the building, television and telecommunications company, is the second most shorted stock, with 9.7 percent of its shares on loan, although shorts have covered by 12 percent over the past month.

Bloomberg reported that net income dropped 29 percent in November 2012, led by a decline at its phone unit. In early January, the company lifted its stake in its telecommunications division with a $899 cash insertion.

New CAC 40 entrant Gemalto, which makes SIM cards and digital security, has seen demand to borrow its shares rise by almost 50 percent in the last month to 8.7 percent, just below the record high of 9.2 percent in mid-January.

Troubled car maker Peugeot has the dubious honour of being the most shorted stock in France. The company has been forced by a court to pause its restructuring plans while workers go on strike, which has expanded to rival Renault factories, according to Bloomberg.

Demand to borrow Peugeot shares is just below the record high of 18.2 percent that was seen on 20 January and now stands at 16.9 percent of the total share capital. This represents over four fifths of the shares that can be borrowed, meaning it would be hard and expensive to short any more of the company

Overall, the CAC 40 dividend outlook this year is expected to be better than 2012, according to Markit dividend forecasts.

There are no annual suspensions expected and only a few companies are forecast to cut dividend payments. However, the positive trend is conservative. Many companies are forecast to maintain dividends and some increases come after dividends were severely cut in the previous year; in several cases dividends have not reached pre-crisis levels.

GDF has the highest dividend yield of CAC 40 constituents for the coming year, although the company is expected to maintain a flat dividend at €1.5 for the year, the same level as the previous two years.

France Telecom is the second highest in terms of yield and this is despite the company stating that it will lower the FY12 dividend to at least €0.8 per share.

The telecoms company has cut its dividend policy to 40 to 45 percent of operating cash flow for FY12 and FY13, following the trend across almost all major European telecoms companies.

Insurance company AXA has a forecast yield of 6 percent, with the dividend expected to grow over 10 percent, taking into account the company's policy is to target a pay-out ratio of 40 to 50 percent. Last year the payment was kept flat year-on-year.

Of the three major French banks, BNP Paribas was the only bank in the CAC 40 to pay a dividend in 2012, and Markit predicts that it will raise its pay out by 20 percent for FY12.

Societe Generale is the only company that Markit is forecasting to resume dividends in FY12, while Credit Agricole is expected to not make any payment for a second year.

Markit ETP tracks 25 active ETPs with exposure to France, with three launched in the last year. In terms of performance since the start of 2013, there has been a net outflow of French focused ETPs of approximately $77 million.

However, AUM increased from $5.6 billion to $5.7 billion due to strong performance in CAC40 products, which benefited from around a 3.4 percent price increase.

Among the top six ETPs by AUM is the US-listed iShares MSCI France (EWQ), which saw $9 million inflow and a 6.4 percent price increase, although the Lyxor CAC tracker sees the greatest AUM of $2.6 billion.

Surprisingly, the Lyxor leveraged CAC 40 product (COLVC) saw a $38 million outflow, despite a 6.8 percent price increase.

January saw a marked increase in relative volatility skew for both the CAC 40 and Euro Stoxx 50 indexes. Relative skew, in essence, measures the steepness of the difference in the implied volatility curve (between the 90 and 110 percent strikes divided by the At-The-Money implied volatility).

Last autumn, the spike in the relative skew reflected market concerns about a French credit downgrade whereas the broader measure barely moved, as is evident from Markit equity volatility.

The spike for the CAC 40 since January appears to be in line with the broader European outlook. So, what could be driving this given the equity market rally and as the overall level of volatility falls?

Adam McIlroy, director at Markit equity volatility, points out that skew is primarily driven by supply and demand. Investment managers have a tendency to write call options to enhance returns and also buy puts as a hedge against long stock portfolios.

The question behind the increased relative skew is whether this a return to 'normal' investing practices potentially indicating a move back into equities by portfolio managers, or whether this is a false rally with the expectation of a correction being priced into the cost of hedging (put buying). **SLT**

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PASLA/RMA Conference on Asian Securities Lending

Location: Hong Kong
Date: 5-7 March 2013
ebiz.rmahq.org

This annual event combines the resources of both the Pan Asia Securities Lending Association (PASLA) located in Hong Kong and The Risk Management Association (RMA) located in the US.

Securities Finance Forum London

Location: London
Date: 12 March 2013
www.dataexplorers.com

The Markit Securities Finance Forum is returning to Kings Place on 12th March 2013. Join your peers for this unmissable event.

ISLA's 22nd Annual International Securities Lending Conference

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

Join your peers in participating in timely industry discussions on the latest legal and regulatory requirements, including a triparty repo reform discussion.

18th Annual European Beneficial Owners' Securities Lending Conference

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

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

Industry appointments

Stephan and **Aaron Vermut** and **Ron Suber** have all left Wells Fargo to join the peer-to-peer financing platform Prosper.

Stephan Vermut, the former founder and managing partner of Merlin Securities, joined Wells Fargo on its acquisition of Merlin in April 2012 to bring prime brokerage services to the firm.

Prosper has appointed Stephan Vermut as CEO and member of the board of directors, where he succeeds Dawn Lepore, who served as interim CEO since March 2012.

Prosper also named Suber as head of global institutional sales. Aaron Vermut will join as president after a transition period with Wells Fargo.

They will work closely with Stephan Vermut, and new business partner Sequoia Capital, which led a $20 million round of financing in support of the new team.

Sequoia Capital partner **Pat Grady** will join the Prosper board of directors.

"I've watched with great interest over the past few years as the peer-to-peer lending industry has grown substantially, and I believe Prosper is in a unique position to offer both borrowers and lenders unprecedented access to financial opportunity," said Stephan Vermut.

Suber, a former managing director at Wells Fargo Securities and head of global sales at Merlin Securities, will be responsible for expanding Prosper's presence among institutional investors.

Aaron Vermut, currently managing director and head of prime services at Wells Fargo, was a founder and managing partner at Merlin Securities. As president of Prosper, he will drive the strategic direction of the company.

Wells Fargo spokesperson, Elise Wilkinson, said: "Stephen and Aaron Vermut built a strong and robust business that is now part of Wells Fargo Prime Services. We look forward to the continued growth of our prime services division, and wish [them] well as they return to their entrepreneurial roots."

"We remain committed to growing our prime services group and leveraging the investment we made in Merlin. Our markets division management team has deep bench strength and will continue to run the prime services group, providing industry-leading customer service and execution."

The International Securities Lending Association (ISLA) has appointed **Andrew Dyson** to the newly created role of chief operating officer, starting in March 2013.

Dyson previously had overall responsibility for managing Markit's securities finance consultancy business. He has also held positions at Data-Explorers, Prudential M&G and Deutsche Bank, with roles spanning business development, risk management, agency securities lending and repo product management.

Richard Thompson, chairman of ISLA, said: "I and the rest of the board feel strongly that ISLA has an increasingly important role to play in helping the securities lending market evolve and respond to the regulatory changes that are affecting financial markets around the world."

"We are delighted that we have been able to attract someone of Dyson's experience and capabilities to this new position."

Eurex Group has made management changes at both Eurex Repo and Eurex Bonds GmbH.

Peter Reitz has departed, having served as managing director at both companies since 2006, but he will continue to bear overall responsibility for the two subsidiaries on the Eurex executive board.

Frank Gast and **Rene Winkler** are the new appointees to the Eurex Repo management team, with Marcel Naas remaining managing director at Eurex Repo.

Gast had been head of sales in Zurich since 2010 and was previously responsible for developing the securities lending market. Winkler has been responsible for corporate and market development at Eurex Repo since December 2007.

Johannes Wessling is a new appointee to the Eurex Bonds management team. He will assume responsibility for all Eurex Bonds business activities, along with Marcel Naas.

It has been reported that Mark Patterson, who worked on Macquarie's dividend arbitrage and stock loan desk in London, has left the bank.

A spokesperson for the bank declined to comment.

Zubair Nizami, a senior securities lending trader at Robeco, is set to depart in February, according to sources.

Nizami joined Robeco from Northern Trust in April 2011, when the firm opened a lending desk in Hong Kong.

The Abu Dhabi Investment Authority (ADIA) has appointed **Gregory Eckersley** as global head of internal equities, effective immediately.

Eckersley will be responsible, alongside senior management, for developing and implementing investment strategy for the internal equities department, as well as overseeing the activities of all internally-managed portfolios.

His role will also include oversight of risk management and due diligence processes. Based in Abu Dhabi, Eckersley will report to Mohamed Darwish Al Khoori.

Eckersley joins ADIA with 16 years experience at AllianceBernstein. From 2006 until his departure in 2011, he was responsible for managing AllianceBernstein's global and large cap growth equity portfolios based in New York.

Eckersley joins ADIA from 1770 Capital Partners, a fund that he launched in 2011 with two colleagues that focuses on the global energy, mining and commodity space.

Bas Cohen has left ABN AMRO. A spokesperson said that Cohen, who was previously global head of trading, departed to pursue a career outside of the bank.

ABN AMRO also closed its Delta One trading Desk in November 2012. "ABN AMRO has a moderate risk profile, and we decided that Delta One arbitrage trading doesn't fit in with our profile," said a spokesperson.

"As well as this, it is not client focused, which is one of our main interests." SLT

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Viranchi Kumar Sharma

Meet Viranchi Kumar Sharma, a former stock loan and borrow settler who is looking to get back into the game

Tell us a little about yourself

My name is Viranchi Kumar Sharma. I was born and raised in Jaipur, India. I have the temperament to handle people with care and an analytical mind that helps me to make the right decisions under pressure and in difficult circumstances. I am very close to my father. I learnt the ethics of life and how to handle multitask projects from him. I'm also a quick learner.

What industry qualifications do you hold?

I am a graduate in commerce from the University of Rajasthan. I am currently in the last semester of my Master of Business Administration major in finance from the Institute of Management Technology in Ghaziabad.

What are you doing at the moment?

I am currently a part of Bank Of America Merrill Lynch working as a senior team member and I am a part of corporate actions (dividend and proxy voting). My best experience of this so far was when I migrated this process from Dublin, Ireland. It was a great experience for me and I learnt so many things during this migration.

What area are you looking to get back into?

I really want to get back into stock loan and borrow settlements. I really love working under pressure and working on each and every trade booked with all of my strength. I can also utilise my analytical mind while working in stock loan settlements. The best time is dividend season when I get to work on record date stocks.

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

The different phases that I have gone through in my life—at school, college and throughout my career so far—have taught me things that I can bring to a future role. Of particular importance to a future role in stock loan settlement is my work experience at Barclays Shared Services from July 2007 to December 2009 and Deutsche Bank Global Services from January 2010 to April 2012. My current role at BA Continuum (a non-bank subsidiary of Bank Of America Merrill lynch), which I have held since April 2012, is also important.

At BA Continuum, I maintain the daily deadline proxy voting, ensure that all the dividend events are released on time and provide constructive feedback to my manager about team strengths and weakness.

In my role as an analyst at Deutsche Bank, I supervised the entire process and ensured that the daily KPIs were met. I also maintained low failing trades in their respective markets and monitored record date trades to ensure that they settle on the same day.

At Barclays, where I was a process associate, I consistently met balance transfer targets while allocating and distributing work processing team members, ensuring that resources were optimised. I also proved that I am a quick study, with an ability to easily grasp and apply new ideas, concepts, methods and technology.

What do you feel the industry needs most?

The industry is really doing well and has lots of support from those who are a part of it. I think that the industry needs to flourish in other countries as well so that people can be made aware of how important it is.

What can someone from your generation learn from the older and more experienced professionals in securities lending?

There is always a lot to learn from older and experienced people, because they go through more situations than anyone younger. So someone from my generation can learn the critical situations that experienced professionals would have seen in their career. In securities lending, business is challenging everyday. Some examples can be how to minimise the risk of buy-in as this is reputational and financial loss, and how to get prepared for dividend season, as this the most important time of the year in securities lending. Rules that should be followed in any market (apart from the basic rules) and what are the best ways to increase profit are good examples too.

I think that the industry needs to flourish in other countries as well so that people can be made aware of how important it is

What are your ambitions?

My ambition is to become a trader at a securities lending and borrowing firm, so I can use my skills working under pressure and make the most of my analytical mind. To become a trader has always been my dream and I believe that I will be good at it.

How would you like your securities lending career to develop—do you see yourself in a specific role in the next decade?

I want my securities lending career to develop as per my knowledge, my experience and my performance. First of all, I want to master the securities lending business and while working I want to prepare myself to be a part of the trading desk. If everything goes according to plan, in next decade I see myself in a vice president position at a trading desk. **SLT**

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