Seeking value in a risk-averse climate






Attendees

SHARON WALKER, managing director, EquiLend Europe
SARAH NICHOLSON, head of securities lending, Aviva
MARTIN TURNBULL, repo portfolio management, Aberdeen Asset Management
JOYCE MARTINDALE, head of investment operations, Railway Pensions Management & Investments (RAILPEN)
SIMON LEE, senior vice president, eSeclending
FRANCESCA CARNEVALE, editor, FTSE Global Markets

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OVERARCHING TRENDS

SIMON LEE (eSECLENDING): Right now, beneficial owners, first and foremost, are asking themselves whether they want to be in the business, and whether it makes sense for them to participate in securities lending. For those that think it does not make sense, they may well have made a decision to pull out of the business, to suspend their programmes, perhaps permanently. For lenders that have made the decision to stay in the business, many will regard it as an opportunity to revamp their lending programmes. Obviously the awareness of the business has been heightened over the past 12 months or so, and lenders are now making decisions around how they actually want to participate in the business, and how they want their programmes to be managed; whether that means refining the type of collateral they will accept, or looking at alternative routes to market. Lenders have a far greater awareness of the business nowadays and a much better understanding of how they can manage their programmes than perhaps they would have before.

SHARON WALKER (EQUILEND): We have seen real changes in the market, many of which have been driven by risk, that is, the need to contain, or control of, risk. We have also seen some regulatory changes come into play as well as a drive to get the best value from the underlying asset. In turn, we see more in terms of the trading that is executed via EquiLend for non-GC transactions. We are also being asked for more input by our clients with regards to collateral management. We have transparency on the counterparty side, because we are in a bilaterally-driven environment over EquiLend. We comply with the regulatory changes and more recently, in Europe, we now have agent lender disclosure. Overall, a continuing desire by our clients to ensure that they have risk mitigation, fully and well controlled.

SARAH NICHOLSON (AVIVA): We have gone through a process of reviewing the business, the controls, and the risk appetite of clients, ensuring that they understand this business as we think they understand it. This comprehensive review of all of the practices within the business has ensured our approach is robust and that risk levels are appropriate for each individual client, properly managed and reported. Underlying clients have a need for more information, not only about market practices, but also on a day-to-day basis about the risks they're taking, and the sort of positions they are running. There are also questions about the risk-rewards in securities lending.

MARTIN TURNBULL (ABERDEEN ASSET MANAGEMENT): Two years ago Aberdeen had only a couple of custodial schemes, which worked pretty well. In the last 18 months, we've done two quite large auctions. The opener was the first major third-party arrangement that Aberdeen entered into. You must understand, Aberdeen is extremely conservative and it looks upon these arrangements as added income, but only provided they are happy with the risk. In fact, the way we set it up has proven very robust through the Lehman's crisis, and adjustments we have made to the firm's custodial programmes are also seen working well. It has given Aberdeen a great deal of comfort that the firm took that really conservative approach. You hear horror stories about cash reinvestment, but participants these days are much more aware of the risks involved and that can only be a good thing. Recent events have underlined the fact that if you adopt a strict collateral profile you get a lot of protection, but perhaps not such a big income. That is a choice, however, that you have to make. We are looking to grow the business more, but not in a rush to do anything radically new and certainly nothing risky.

SHARON WALKER, managing director, Equilend Europe

MINIMISING RISK

MARTIN TURNBULL: Our fund managers look at the additional income they get from securities lending as very welcome, obviously, but they want the minimum risk, and also to maintain continuity in the day-to-day cash trading. It is very important that corporate governance is taken care of. Our clients and fund manager take their corporate governance responsibilities very seriously and insist on being able to recall to vote. It is important to a lot of our customers, that they feel their input is being observed, so you can't compromise on that. Brokers come to me with ideas of doing synthetics. I usually tell them: "We can't do that for a year, because what if we want to vote? You can't get it back". With securities lending, exclusives or a custodial programme, you can call back lent securities at any time. It is also important that reporting is transparent and clear. That's one thing we've insisted on, and it's worked for all our providers: they've managed to give us detailed reports as to exactly the collateral involved. Not the collateral you're just expecting to get, but actually what you have got. There have been problems with that, not for us directly, but I understand that during the Lehman collapse some tri-party cash providers had all sorts of stuff that they weren't anticipating placed as collateral. But if you actually see it reported it gives people comfort. Overall, there still seem plenty of borrowers out there. In our last auction, the actual results from July were pretty similar to the year before, and we had more participants and more winning bidders.

SHARON WALKER: Externally, the regulatory framework has to be in place to allow this business to continue and the risk-reward ratio needs to remain. There's been a lot of review around balance sheet use, and people have been watching very carefully their use of balance sheets. In managing the securities lending business, as resources have been cut in the last 12 months, probably to, in some cases, very, very lean numbers, that continues to drive the need for cost-efficient businesses. So, in order to make a sound return on the business, there has been a growing demand on people to run their business efficiently and with the resources that they have. So it's a combination of factors, really: regulatory framework, the fact that the market is sufficiently buoyant with opportunities available, and that people can enter and maintain the business along an efficient and cost-effective path.

ROUTES TO MARKET

MARTIN TURNBULL: It has to be a business decision in the end. You have to look at what's best for the fund, and if a custodian can do the best job (that you perceive at the time) then leave it with the custodian. However, if you can get significant extra value by doing, say, an exclusive one-year auction, then this should of course be looked into. From the borrower's point of view, there is no guarantee that they can have those securities for a whole year, but they calculate a value by using data such as turnover levels and bid accordingly. Our experience of the auction process has been positive; it's worked very well for the funds we selected. All the recalls and corporate actions have worked. Potential routes to markets can be influenced by the size of the fund and its turnover. We don't for example lend any small-cap stocks. Choosing a route to market it is actually about assessing what sort of value you're getting, which can be difficult to quantify. Despite all the data that's available, you're not always comparing like for like. You can look at the data and it may show that someone's got a higher income than you. However, are you both taking the same collateral? Was it the same amount? It is not always black and white.

SIMON LEE: Custodians will continue to be the largest pool of supply for borrowers, given their captive client bases and the sheer number of clients that participate in the businesses. However, market dynamics have changed, and more lenders are looking at alternative providers to their custodian. That could be another custodial bank providing that lending service, but there are certain lenders who will be looking at other options. Custodial programmes are set up to provide a pooled product that serves a large client base, and for those clients for which that structure is suitable, they will most likely remain with their custodial lenders. The dynamic won't change in that respect. For lenders that are better served outside of a pooled custody arrangement, it is a different story. Lenders that are more minded to look at alternative routes to market will be more inclined to do so now.

SARAH NICHOLSON: What's apparent right now is that there are a number of beneficial owners who are in programmes, would like to get out, but because of cash reinvestment and the potential of crystallised losses, are unable to do so. Over the next 12 to 18 months, we will see a lot of people coming through this and reviewing where they are and their provider. That's not to say they'll change, but they will go through the process, and the market will move ahead with an increased awareness and understanding among beneficial owners. Regarding Simon's comment that this isn't something that you just sign up to and receive a cheque every month: the decision to appoint a lending agent, whether it's the custodian, a third party, or an in-house provider, is going to be a much more conscious decision. Actually, there is room for all of the routes to the market, because there is no one-size-fits-all. What I would say is that a lot of the very large programmes have tended to be run in a one-size-fits-all method, where you tick the box to choose the parameters

SIMON LEE, senior vice president, eSeclending you want. However, going forward, I do not think this will continue to be an appropriate model for a lot of people. In consequence, we'll see a lot more bespoke, focused kind of structures coming in, and, off the back of it, more alternative routes to market and alternative lenders, or agent lenders, away from the custodial banks.

JOYCE MARTINDALE (RAILWAY PENSION INVESTMENTS—RAILPEN): It will depend on the size of the beneficial owner. There will be small pension funds whose only option of coming to market will be through an agent lending programme, so it will still be there for them, as I don't think the likes of eSecLending wants lots of small pension funds coming to auction.

SIMON LEE: No, as we've said, lending for segregated accounts, utilising an auction tool, and lending via an exclusive route to market, does not suit all lenders, and smaller accounts holding assets that are in less demand could well be better suited to a custodial pooled programme.

JOYCE MARTINDALE: Even for larger beneficial owners, if you use an exclusive route, you're promising that you'll have a relatively stable set of assets for a period of time. Now, it could depend on which asset managers you use, or you may be planning some asset allocation changes, which you know might happen in a year's time, so therefore you know you can't actually enter into an agreement like that.

JOYCE MARTINDALE, head of investment operations, Railway Pensions Management & Investments

CHANGING RELATIONSHIPS

SHARON WALKER: Certainly, we're probably finding there's been some change there. Not a massive sea change, although we clearly like to think of ourselves as more of a partner, rather than purely a provider, because we ourselves are regulated in the marketplaces. We continue to stay very close to our clients. We have equity owners which represent some of our largest clients as part of the EquiLend consortium, and over and above that, we have another 40 or so clients globally. What we do continue to do is to encourage clients to talk directly with us, or through a number of groups and forums. Moreover, we try to stay abreast of such things as regulatory change, market dynamics and so forth. We always endeavour to be quick to respond to our clients, and the market, if we can, and we create releases and changes to our service on a regular quarterly basis.

SIMON LEE: I don't think securities lending is an overly complex business. It is an evolving business, and you can argue that the rate of evolution has increased over the last 12, 18 months, driven by market events, but the relative level of complexity hasn't changed overtly. What has changed is that people's understanding of the business has improved, driven by a need to know what's going on in a programme, and what kind of business is being managed. That, in turn, drives an increased level of transparency, however I don't think the overall level of complexity inherent in securities lending has changed fundamentally. Nor will it.

SHARON WALKER: I agree insomuch as I don't think the complexity has changed, but I do think the scrutiny, if you will, or the ability to look very, very closely into what's going on has stepped up. Everybody now wants to know, exactly, why is that firm getting more than me, and I've got the same asset? Additionally, the focus around collateral is changing: the need to be very sure and confident about what you are holding, and that your business is in line with all the regulations; all that's become very tight. So I would say it was the forces outside that are changing some of the behaviour in the business.

SARAH NICHOLSON: I absolutely agree, and the relationship between the beneficial owner and their agent lender becomes more and more critical, because the beneficial owner is no longer happy to receive a report at the end of the month that says everything is fine, that there's no need to worry. They want to see every scrap of information; they want somebody on the end of the phone who they can ask: "Why is this fund getting more than me?" Or: "Why am I not getting fair value for this?" The beneficial owner wants that level of engagement now, and so the relationship between the beneficial owner and the lending agent is becoming increasingly more important.

SIMON LEE: …Which, from our perspective, is obviously a big positive, because it prompts questions about routes to market, it prompts lenders to investigate what programmes are available to them, and, it prompts lenders to look outside their existing providers.

SHARON WALKER: Several of us were at a conference recently and one of the questions was: "What prompts people to look at different agents?" I think it was Joyce, actually, who may have come back with a response that at the end of the day it was about service degradation. It wasn't necessarily about income. Actually, people would be accepting of potentially a lesser income, but they may not be accepting of a lesser quality of service.

SARAH NICHOLSON: The interesting thing there is around the degradation of the service, and the fact that the income isn't necessarily the most important thing. Historically it seemed that the key decision around who you appointed as your agent lender was simply who will make you the most money. Hopefully we will see that change, as too often in the past it's just been whoever estimates the biggest number is likely to win the business.

JOYCE MARTINDALE: I would expect custodians that don't keep up with the spend in IT required for the need for transparency would end up being the losers. It wouldn't be just a securities lending experience that makes you select your custodian, because you've got the custodian in any case to ensure the safety of your assets. That's the key thing, above and beyond this area of business: securities lending is a nice addition to that, but it's not the only factor.

SARAH NICHOLSON: The unbundling of securities lending away from a custody service decision is a trend we are definitely seeing. In the US, it's not seen in that way at all, and we're increasingly seeing that more in Europe. You know all of the custodians, all of the big lending agents, and a number of newcomers to the market are in a position to be able to offer lending services, without having the custody, and so where the lending is undertaken becomes much more transferable and transient. For the custodians, undoubtedly, it will be a challenge, but as these increasing demands from beneficial owners come through, they're going to have to deal with it. That's not to say that they can't deal with it now. I don't have custody lending, so I don't know what their services are like now, but absolutely, as the demands comes, they will have to meet it.

WHICH PORTFOLIOS SUIT AUCTIONS?

MARTIN TURNBULL: Not every portfolio is suitable for auctions. The beauty of doing an auction is, usually, you get a much higher return, and you can demonstrate transparency. The competitive nature of the auction proves that you've gone for best execution. The post-auction data clearly demonstrates this. So if it suits the portfolio (and not all portfolios are suitable), those that are stable have relatively low turnover, we consider auctions a good route to market.

SARAH NICHOLSON: Martin, I've got a question about the auction route: one of the concerns, I guess, is the concentration of risk. So when auctioning off a portfolio to a single counterparty, does it not concern you that you have that concentration of risk?

MARTIN TURNBULL: Yes and no. We do get a 5% haircut in our favour, obviously, and its good quality stock (G7 debt only). Our risk department is always monitoring the process. We also monitor the counterparties ourselves, and, of course, you can always close off an exclusive. If you get uncomfortable with anybody, you forego the rest of the fee, and well, that's a business decision. Concentrating the risk on one counterparty? The maximum for, say, Luxembourg Funds, the maximum you could possibly lend, is 50% of the value of the fund over the year, and in reality, it's probably only a maximum 20%.

BUSTING MYTHS AROUND SECURITIES LENDING

JOYCE MARTINDALE: What might help, and this has been an age-old theme, is to get more transparency and more education for beneficial owners.

SARAH NICHOLSON: What frustrates me is when you hear beneficial owners say: "Well, we participate in lending to cover some of the fees." It is almost as if it is a no-risk aspect to the business. That is patently not the case. It needs to be seen, and it is increasingly being seen as an investment strategy. Now, clearly it is not the sort of investment strategy that you're going to launch a fund around: it is a very much of a value-add, overlay strategy. Nevertheless, it is an investment strategy, and should be seen as that. It has to be placed, as Joyce says, in the context of the overarching investment strategies pursued by fund managers, because that element delivers most of the performance. Securities finance can only ever add to that, it cannot drive the performance of the fund. Moreover, you do not buy assets to lend out, you only lend those assets you have already bought. It is very easy for people in the industry to forget the pecking order, almost, within a fund.

JOYCE MARTINDALE: We should probably myth-bust on the "covering the fees". The comment should be viewed in relative income terms. The returns from investment portfolios will have a bigger impact on your overall funding level than the income from your securities lending. The Railways Pension Scheme manages risk very effectively; though we do expect that the order of income would be something that will cover the types of fees that we incur in undertaking some of the investment processes. However, we are not expecting anything bigger, and that's how we've designed our lending programme.

SARAH NICHOLSON: I'm not suggesting that that's an inappropriate approach, but you have a very conservative programme, and you're almost designing it because you don't want the additional risk, and that's the purpose for being a participant in the industry, and obviously there's a whole range of risk appetites out there. Therefore, the returns can be significantly higher than paying the fees, and generally should be seen as part of the performance of the fund.

SIMON LEE: Going forward, the days of lenders giving their business to their custodian and collecting a cheque each month, and not really thinking about what's happening behind the scenes are most definitely gone. However, because a lender runs a very conservative programme, to your point, Joyce: that's an active decision that's been made, to run a programme in that manner, and essentially, it's an investment decision that's been made, to run the programme in that manner. And that part of the business, I don't think will go away for the foreseeable future.

MARTIN TURNBULL, repo portfolio management, Aberdeen Asset Management

SARAH NICHOLSON: But having 20% in one place
MARTIN TURNBULL: It does seem a lot, I agree. But that is why you have quality collateral and it is conceivable to have just as much out to one borrower in a custodial scheme.
SIMON LEE: It also important to make the distinction between principal lending and agency lending. Principal lending is when the beneficial owner of the securities contracts directly with the borrower, which is typically under an exclusive arrangement, and that's where you have the level of concentration that Sarah's referring to. Under an agency programme, whether you're lending via exclusives, discretionary trading, or a combination of both, you do have the ability to diversify amongst a wide borrower base, and I'd make the point that the vast majority of auctions that eSecLending undertakes are awarded to a number of winning bidders, and that the lender achieves the diversification across borrowers through that route. I'd also say that, if you look at custodial programmes, probably pre-Lehman's, when the custodial business was very much run on a specials versus GC allocation type arrangement, the level of concentration that lenders had to the larger broker dealers probably outweighed the benefit of lending on a pool basis amongst a wide borrower base, as the likes of Goldman Sachs and Morgan Stanley, who were very, very big users of equity finance products, tended to get larger allocations of special securities, which was consequently reflected in larger GC balances. That would create a level of concentration that probably most lenders weren't actually aware of at the time. That's less the case, now, of course: the prime brokerage space has changed, there are more players and the business has been distributed more equitably.
JOYCE MARTINDALE: Even going the agency route, depending on the agreement between yourself and your agent lender, you may have some form of indemnity, which reduces your income. If you're happy with that indemnity, and you're actually clear what it gives you, you may not be as concerned with some of the concentration risks as you would otherwise have been. Moreover, there are various types of indemnity, and if you get one, you do need to make sure you know what it means, and you also need to make sure how many times the organisation giving you that indemnity has given something similar to other clients. However, as long as you understand that, then you may be willing to accept a little bit more concentration . It all rests though on the time and effort you put into your legal agreements up front. We were pleased with our securities lending agreements over the Lehman's bankruptcy last year because we knew exactly where we stood.
SIMON LEE: I'd say you were probably in the minority there, in that many lenders were not as well versed as you as to the legal terms of their indemnification policies. The Lehman event gave people a wake-up call, and caused many lenders to immediately move to review their legal contracts.

COLLATERAL AND REINVESTMENT

MARTIN TURNBULL: We don't do any collateral reinvestment, it is as simple as that. As I said earlier, we run a conservative programme. We only take government G7 bonds as collateral. We used to take a mix of collateral on our custodial programmes but when the Lehman's default happened, we changed all profiles to G7 only. Actually, personally I have no problem with cash reinvestment per se, as long as everyone's aware of the risks. Yes, there have been some horror stories, it's no comfort but some of the troubled programmes, were signed off on ten or 15 years ago, by people who no longer work in the business. So accountability and vigilance is very important today.
SARAH NICHOLSON: We don't do cash reinvestment either from the UK. We do take cash as collateral, but it's all then reinvested through a securitised basis, so it's all on a repo-type structure. Cash reinvestment has had a bad press over the last few months, and I completely agree with Martin: it's not a bad strategy. It just has to be recognised that it's a higher and different risk than taking non-cash collateral, and with it comes a higher return, undoubtedly. I wonder whether some of the cash reinvestment mandates that have been around for three years or so are written as a blacklist of what you can't take. It might be a bit extreme, but then CDOs come along and it's not on the blacklist, so suddenly it becomes an eligible reinvestment. The guidelines need to be under constant review. Now, since Lehman's, we've done quite a lot of analysis around different types of assets and how they reacted in the immediate aftermath of Lehman's, and what might happen in the event of another default. From looking at volatility and liquidity, and taking those scenarios into account, we've changed some of our non-cash collateral parameters. Historically, we would have seen lending government bonds versus equity as probably one of the higher-risk trades, because you'd absolutely expect

governments to go up and equities to go down after a major financial default. However, because of the margins that we take, and because of the ability to sell those equities very quickly in the market, we are now very comfortable with the trade. What we're not happy with is long-dated corporate bonds as collateral, because, post-Lehman's, if you talk to non-cash takers, the one issue that most will have shared is the difficulty in selling those assets at the price that you needed to sell them, in the timeframes you had. So, where we focused a lot at volatility, we are now looking equally at liquidity, in recognition that it's about speed to market and speed of the restitution process.

SHARON WALKER: From a trading platform perspective, we make no recommendation, nor do we lean one way or another: we handle trading with both cash and non-cash collateral. We don't make any distinction about it and we accept trades that are covered either way. What we have seen is a greater use of tri-party. Again, that speaks to risk-mitigation people seeking to use tri-party to better control their risk. What we also see is where more collateral is tending to change hands ahead of the settlement. We've had a request from our clients to be able to effectively compare and agree the collateral that's moving ahead of time. We have responded to that request and provided a process that enables people to ensure that the levels of collateral they are receiving ahead of time are correct, and as you would expect them to be.

SIMON LEE: Expansion of non-cash collateral is one area of the industry that moves relatively slowly. While there's probably an opportunity for change to occur over the coming years with respect to a greater level of acceptance of equity collateral, I still think it would be a slow process. Intuitively, whilst lending equities against main equity index collateral can make sense, it's still a relatively new product for most beneficial owners, and will take a long time to become more readily accepted. On the cash-side, what you will see is more specialist money managers coming into the securities lending reinvestment space, in recognition of securities lending cash collateral being a viable source of liquidity. This is illustrative of the idea of unbundling in the securities lending business and utilising a specialist lending agent to lend your underlying assets and a specialist money manager to manage your cash collateral.

REGULATORY CONSIDERATIONS

MARTIN TURNBULL: When the short-selling ban came in, Aberdeen took the decision to not lend any of the names on the list. Did it make any difference to the price of those shares? I don't think so. The actual numbers of the shares in the market that were out was tiny. So I don't think it had any effect on the market.

SARAH NICHOLSON: If the objective of the short-selling bans was to prevent the price of the shares from freefall, it clearly failed as a strategy.

MARTIN TURNBULL: Exactly. It just encouraged those that were selling it to give the market even more of a kicking. The regulators now recognise that short-selling is an important part of the market. It's all part of business, but the regulators did what they thought was right at the time. It was a panic situation: there were perfectly healthy banks just getting trashed for no other reason than that the market could.

SARAH NICHOLSON: What it did give us is an opportunity to analyse the market without shorting in it, and to see whether prices go down, despite there being no shorting. Clearly, it was not only fund managers dumping stock that was causing the price falls, but research suggests it was a big factor—which, I guess, from a defending the stock lending industry perspective, can only be a good thing.

FRANCESCA CARNEVALE: Your view is tempered by your experience. However, if you were a beneficial owner or you were a trustee, would you have felt confused, or frightened in this really knee-jerk period?

SARAH NICHOLSON: Absolutely. At the end of the day, the press have a lot to answer for here because in all of the newspapers it was all about these evil short-sellers and the Archbishop of York and Alex Salmond pointing fingers and it was an easy target, to blame this industry because of the short-selling. It made a good story.

SHARON WALKER: Actually, it was the relatively smaller lenders which, because of the short-selling bans, pulled out of the market. They wanted to step back, calm down, regroup and then compose themselves. However, a number of funds have indicated that they are now coming back into the market. For EquiLend, of the four or five that withdrew from the market, they're pretty much all now back in, with maybe only one or two funds that remain outside. The turmoil in the market has left everybody a little skittish, but I do think, in time, people will just go back to where they were. For the time being however, until a sense of equilibrium has been reached, people will continue to be very cognisant of the regulatory requirements, and have a keen awareness that they adhere to it. Some of the short-selling bans were criticised with being overly long. But for the most part, most of those bans now appear to have been lifted.

JOYCE MARTINDALE: I thought that some of the more interesting comments, or maybe less well-informed comments, were indicative of the fact that, as an industry, securities lending is quite complicated. There are a lot of different parties involved, and it's not very well understood. David Rule (formerly chief executive officer, ISLA) did a very good job, but ISLA was on the back foot at the time, given the coverage. I think you need to educate people in a time of calm, but who's the best person to take a lead on that and who's going to get that news out there?

SARAH NICHOLSON: From ISLA's perspective, education is the only way forward, and they will be taking a lead in educating regulators etc. Although it can be difficult because it can be seen as self beneficial PR for the industry

SIMON LEE: Also, in periods of calm, I don't think journalists are that interested in understanding or knowing. Nor is the average man in the street, because stock prices are rising, and everyone's happy. That's part of the issue: that it only becomes a story, and people are only interested in learning more, in times of crisis

JOYCE MARTINDALE: There was such a barrage of negative comment last year so surely people realise that they're going to have to push that education to regulators and the market in future.

SHARON WALKER: People have also highlighted the fact that there hasn't really been a spokesperson or spokespeople group for the industry.

SARAH NICHOLSON: ISLA's had a chief executive officer now for 18 months, so we're in a better position than before; it's the first time we've really had an independent spokesperson for the industry. More importantly, I was just going to comment on the evils of stock lending, and one of the things I quite like to point out to people is that a lot of funds are very pleased that they hedged their positions over recent months, and it's worth remembering that they can only hedge it because there's an active lending market behind it. So that's one of the best safeguards anyone's had over the last 12 months, and it's been facilitated by stock lending.

SIMON LEE: Something that summed up for me the lack of understanding in the media was the reporting of a pension fund that had hedged their currency exposure on their overseas investments, and being berated for selling sterling short—never mind that the fund was managing risk for the benefit of the investors.

FRANCESCA CARNEVALE: OK, but that's not always the whole approach is it? I was amazed, for instance, that the market didn't actually throw its hands up in horror over the whole of the Porsche-Volkswagen affair.

JOYCE MARTINDALE: That's a far more market-manipulating thing there, isn't it? You couldn't do that in the UK, I don't think. You couldn't build up such a long position in a company without having to declare it. Actually, you are right, no one was really upset at the short-sellers. In that case who did lose quite a lot of money there? There wasn't a hue and cry then.

SARAH NICHOLSON: Actually, Germany's one of the few countries where it could happen.. It is not really a story for the vast majority of the population. It's a carmaker in Germany, and their share price is being manipulated. That is not particularly applicable to a big, big part of the public. From a stock-lending perspective, the funds that loaned those shares were the winners. They got the revenue. The hedge funds that ultimately borrowed it were the ones that lost out, and the funds that weren't lending would have got less of a performance on those assets. Weren't they at one stage the most expensive company in the world? And at that point, lenders were getting a fee off the back of that value, without taking any extra risk or increased exposure on the asset itself, whereas the hedge funds that were running the trades, they're the ones that took a bath.

SHARON WALKER: What's interesting is that the press picked up on the fact that the hedge funds lost money over it. That was interesting, not necessarily the underlying strategies and the sort of transactions involved.

JOYCE MARTINDALE: But UK funds will have owned one or both of those shares, and they should have been concerned about that: if you've got any European equity exposure, it will impact your pension funds and therefore you should be interested in that.

MARTIN TURNBULL: It couldn't happen in the UK because we haven't got two public car companies, have we? [Laughter]

A NEW GROWTH SPURT?

SARAH NICHOLSON:
From our business perspective, we are in a growth period, now. We have come through the last 12 months strongly, with huge internal support for our securities lending activities and the business is definitely into a growth cycle. From an industry perspective, all lending agents will continue to be challenged by the underlying funds. You'll see more bespoke specialist lenders evolving and coming to market, and much more of a continued recognition of the investment strategy of lending. Make no mistake, it is a real challenge to the market, to continue to increase the transparency, increase the understanding, and really take the industry to the next level.

SIMON LEE: If we just look at some of the key metrics in our business at eSecLending—additional client mandates, levels of exclusive fees being bid, and most tellingly, numbers of borrowers bidding on exclusive deals, all are up year on year, pointing to a more positive outlook than a year ago.

MARTIN TURNBULL: I sense an air of optimism in the market in. One of the bigger players across the market held a customer meeting the other night at which they stressed they were having a big push to be top three in all markets globally. One the integral parts of their business was securities lending. Others have been in touch directly expressing a wish to do more in this area, and are constantly looking for more portfolios to value, and other ways to optimise what they've already got. Moreover, companies are hiring again, which has to be good. Not everybody, of course; there are some that are still struggling, and some organisations are being broken up. However, of those firms remaining in the market which are rediscovering their identity, they are looking to beef up their business.

JOYCE MARTINDALE: I can just reiterate what everyone else is saying, and from the beneficial owner's side, they'll be looking to understand what they're lending out, what the risks are, what collateral they're going to take, and I suspect some people will become more conservative and remain so, in terms of collateral, for quite some time. It won't be a three month or a six month: if people go more conservative, it might stay for a bit longer. Some other people, may go the other way.

SHARON WALKER: We saw some dips in the volume of EquiLend trading volumes about September time, with a dip of about 15% to 20%. What we've seen through 2009 is a pick-up of those trading volumes, and interestingly, we've seen some of our peak numbers ever in August and July, executing in excess of 20,500 trades in one day, which is a significant number for us, with orders going through the system of many multiples of that. As we look forward, we will have to be extraordinarily aware of people's need to be cost-effective. Everybody is extremely cost-conscious, us included. We are very aware that we need to be able to offer the best service, the best value, at the right price.

THE WAY AHEAD

SIMON LEE: There is an increased awareness, among beneficial owners, of the business, which will prompt more investigation into alternative routes to market, and alternative ways of managing their lending programmes, and an increased demand on service providers. Clients will be looking for customisation, for transparency, and so forth. The obvious challenge is whether service providers can step up to meet these requirements, and how quickly they can step up and provide the lenders what they are demanding.

SHARON WALKER: We are seeing a growing interest in ETFs—generally with people using it as a shorting alternative. There's been a 20% uptick in the issuance of ETFs in the 2007, 2008 space. Talking with some of the ETF issuers, they certainly believe that's going to carry on. EquiLend already has some ETF trading across the platform in the same way as any other warm security. So flexibility, cost-effectiveness, staying and being aware of the regulatory demands of the business, that's where our challenges will be.

SARAH NICHOLSON: We're definitely seeing a huge influx of new opportunities, not necessarily in new markets. Instead we're seeing new strategies and new ways of doing business, and new considerations around the types of stocks you're lending and the types of collateral you're seeing, and the returns on that. With the diversification of broker dealers in the market, and everybody trying to find their places, there's a lot of innovation going on, and a lot of increased understanding from that side of the market as to what the beneficial owner and the ultimate security holder is looking for. ETFs and convertibles are interesting, for example. I guess traditionally, we've always looked at a new market as the new opportunity. We have very little appetite to go into far-flung countries that we don't have complete comfort in, though we do have an appetite for these new structures. Whereas once we might have told an underlying client about a new idea and the money we could make for them, nowadays the discussion is much more about risk assessment and analysis.

SHARON WALKER: We are seeing more use of our trading services in Asia, and we like to think of it now as a very natural market for us given trading volumes. Traditionally it's been a very manual market, so we are pleased to see more take-up of our services, and we are able to offer trading in a number of different guises. We certainly expect to see growth in the volumes traded over EquiLend in markets such as Japan, Hong Kong and Singapore.

SARA NICHOLSON, Head Of Securities Lending, Aviva

MARTIN TURNBULL: We don't really do a great deal in emerging markets, but that can change in the future. Markets are always evolving, that is true of whatever market you're in. Some of the points we have raised about due diligence and awareness have changed, and so you'd like to think you'd never have a situation again where the cash reinvestment was such an issue, or as painful as it has been for some people. Plenty of positives have come out of this period but there are still the negatives of people trapped in some securities lending schemes because they can't get out, without crystallising a loss. However, as markets recover, they will hopefully be able to get out of them without too much pain, and re-evaluate what they're doing.

JOYCE MARTINDALE: I'd prefer more to answer the question: wouldn't it be great if there is growth? Or when will there be growth in the market? Because that, by implication, means that there's more liquidity, there's more confidence in the market, and our supplies of assets to lend have gone up, which would be really good, from a pension fund point of view. I'm interested to hear what opportunities will be out there in securities lending, but if there's overall growth in that market, it means there are other benefits for pension funds.

SIMON LEE: Looking at next year, that growth will come from the abilities of lenders, and their agents, to best manage their lending programmes to meet both risk management requirements, and market demands. That may mean anything from looking at collateral flexibility to lending in emerging markets, or to engage in synthetic lending structures. Lenders that are able to evolve their programmes, and have a flexible approach to how they manage their business, will see that growth.