



US securities lending panel debate

The biggest market in the world has seen its share of trials and tribulations over the past couple of years. Our panel examines the issues

Ben Wilkie, editor



Barbara Eelens
ABN AMRO, Global Markets
 Director

With a rich history dating back to 1720, ABN AMRO is a highly respected and stable banking partner for our clients. We are proud of our heritage and excited by our potential. The bank employs more than 30,000 people and has an international reach across 28 countries.

ABN AMRO Securities provides a platform to conduct securities financing and related activities in the United States where we offer our clients the ability to enhance returns while managing risks. We act as principal in all transactions and specialise in exclusive fixed fee agreements and tailor made securities finance solutions. ABN AMRO Securities is self-clearing, and a member of FICC and NSCC.



Missy Seidel
Brown Brothers Harriman
 Securities lending
 global product head

With 100 per cent client referenceability, compelling economics, and no collateral impairment, Brown Brothers Harriman has proven that a securities lending programme can deliver outstanding performance and robust risk management. Ranked the no.1 Global Provider in the 2009 and 2010 Global Custodian Securities Lending Surveys, BBH provides customised third party and custodial securities lending solutions to many of the world's most sophisticated global institutional investors.



Michael H. Johnson
Penson
 Senior vice president – global securities
 lending, Penson Worldwide



David Kennett
Penson
 Director - head of equity finance – Eu-
 rope and Asia, Penson Financial
 Services

The Penson Worldwide group of companies provides execution, clearing, custody, settlement and technology infrastructure products and services to financial services firms and others servicing the global financial services industry. With a global presence underscored by local expertise, Penson is a leading provider of global securities lending services.

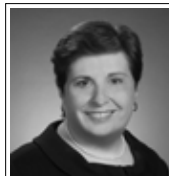
Headquartered in Dallas, Texas, Penson has served the clearing needs of the global financial services industry since 1995.



James Slater
BNY Mellon
 Managing director & chief operating
 officer

BNY Mellon offers clients worldwide a broad spectrum of specialised capabilities, including custody and fund services, securities lending, performance and analytics, and execution services.

BNY Mellon is a global financial services company focused on helping clients manage and service their financial assets, operating in 36 countries and serving more than 100 markets. BNY Mellon is a leading provider of financial services for institutions, corporations and high-net-worth individuals, providing superior asset management and wealth management, asset servicing, issuer services, clearing services and treasury services through a worldwide client-focused team. It has \$25.0 trillion in assets under custody and administration and \$1.17 trillion in assets under management, services \$12.0 trillion in outstanding debt and processes global payments averaging \$1.6 trillion per day. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation.



Karen O'Connor
eSecLending
 Co-chief executive officer

eSecLending is recognised as a leading global securities lending agent servicing sophisticated institutional investors worldwide. The company's approach has introduced investment management practices to the securities lending industry, offering beneficial owners an alternative to the custodial lending model. Its philosophy is focused on providing clients with complete programme customisation, optimal intrinsic returns, high touch client service and comprehensive risk management. Its process is to begin each client's programme with a competitive auction to determine the optimal route to market for different portfolios or asset classes whether it is via agency exclusives or traditional agency lending. This differentiated approach facilitates best execution while delivering greater transparency and control, allowing clients to more effectively monitor and mitigate risks.



Anne M. Sylvester
J.P. Morgan
 Head of regional technical sales and
 client management for financing and
 markets products

J.P. Morgan Worldwide Securities Services is a premier securities servicing provider that helps institutional investors, alternative asset managers, broker dealers and equity issuers optimise efficiency, mitigate risk and enhance revenue. Worldwide Securities Services leverages the firm's unparalleled scale, leading technology and deep industry expertise to service investments around the world. It has \$15.9 trillion in assets under custody and \$7.1 trillion in assets under administration.



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Nick Bonn
State Street

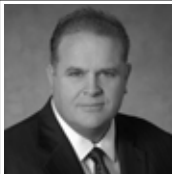
Executive vice president and global head of securities finance

State Street Corporation (NYSE: STT) is one of the world's leading providers of financial services to institutional investors, including investment servicing, investment management and investment research and trading. With \$19 trillion in assets under custody and administration and \$1.9 trillion in assets under management at March 31, 2010, State Street operates in 25 countries and more than 100 geographic markets worldwide.


Chris Doell
Northern Trust

Senior vice president and head of securities lending client relations for North America

Northern Trust began lending securities on behalf of its clients in 1981 and was one of the first banks to lend securities internationally in 1988. Northern Trust aims to provide clients with flexible lending options and an opportunity for optimising returns for loaned securities. Today, it actively lends in 50 different equity and fixed income markets worldwide and continually reviews and expands into additional markets to help benefit clients, seeking to optimise returns through a customised lending programme in the context of thoughtful risk management.


Rory Zirpolo
Kellner DiLeo & Company
 Principal, director of securities lending

KDC Alpha is a matched book trading partnership that replicates the prime brokerage industry's proprietary matched book trading business. KDC Alpha's strategy has generated a positive return each month since inception and is designed to outperform other alternative investment strategies over multiple market cycles. KDC Alpha's performance has demonstrated low correlation to equity and fixed income markets and is especially attractive as an enhancement/hedge overlay for equities, fixed income, ETFs, MLPs, registered mutual funds and precious metal portfolios. KDC Alpha's returns are positively correlated to rising interest rates and volatility.


Greg W. DePetris
Quadrivers
 Co-founder

Quadrivers is a leader in delivering transformational market structure changes to the securities lending industry. Quadrivers, through its wholly owned subsidiary, Automated Equity Finance Markets, Inc, has developed the AQS® market for securities lending. AQS, through its relationship with The Options Clearing Corporation, has created a centralised market for securities lending transactions. As a FINRA member broker-dealer and a SEC regulated Alternative Trading System (ATS), AQS aims to maximise liquidity, access, credit and transparency, while mitigating systemic risk, through a fully automated trading environment.


Chris Kunkle
RMA
 Director, securities lending and market risk

SLT: Considering the experiences your company has had over the past couple of years, how has your securities lending strategy changed, if at all?

Anne Sylvester: The big sea change that we have witnessed in the post-crisis market environment is that oversight, transparency and risk control have become paramount. In a sense, the Lehman crisis proved that our model was efficient in unwinding borrower defaults. It gave lending clients the comfort to know that the mechanism does work in difficult situations and market disruptions. This has been one of the biggest shifts since the crisis. Clients are far more interested in a dedicated separate account type platform and this is where they determine the parameters governing their reinvestment portfolio. It gives them a lot of transparency, oversight and involvement in the process.

Missy Seidel: BBH embraced intrinsic value lending before it was considered "en vogue," and because we stayed true to our founding philosophy, our programme and our clients suffered no

realised or unrealised losses, no collateral impairment, and no liquidity or redemption restrictions. We've always focused on working with clients to co-create programmes that meet their long-term best interests, and we'll stick with that strategy going forward.

Greg DePetris: Our strategy remains the same – responding to the needs of the market in the areas of transparency, credit, and automation. Of course these needs change and advance over time, so the challenge is responding to those conditions whether it means delivering transaction data in real time, improving credit limit management, or increasing the level of straight-through processing. We continue to evolve with our clients and address their needs in a changing environment.

Barbara Eelens: Our securities lending strategy endured the financial crisis without incurring any losses for ABN (previously Fortis Bank Netherlands) or any of our clients as we have always focused on the intrinsic value of underlying securities rather than on the money to be made via a

cash reinvestment programme and we will continue to do so in the future. In addition, our willingness and ability to post various types of non-cash collateral, thus removing any reinvestment risk a client, proved to be a very valuable differentiator.

Michael Johnson: Our strategy is very simple: Provide the best service to all of our clients, including internal and external. We understand the nature of trading strategies and therefore build systems to help our clients receive the best information. We have also focused on our service level and the ability to interact with other clients on a global basis. We have concentrated on hiring the best available personal around the globe, and now have securities lending operations in Dallas, New York, Toronto, London and Hong Kong. Our strong global management team has been very effective in seeing trends and taking advantage of them quickly. All this has enabled us to better service our customers.

David Kennett: Ultimately we have had good success in true globalisation of our securities lending and matched book business. This has



enabled us to take advantage of internal synergies, diversify our business streams, and offer a broad range of securities with the ability to switch focus in geographical markets as clients' demands change.

James Slater: Broadly, our clients have made adjustments to reinvestment guidelines and lending strategies, in many cases reducing the risk of their programme. At the same time clients have asked for more reporting and risk/performance analytics. All of this has led to an increased focus on intrinsic-based lending strategies.

Kunkle: If there's another market downturn and large cap names start trading tighter then liquidity could again be an issue in a minority of cases

Nick Bonn: Overall, when looking at our programme, I think State Street largely avoided the credit problems that many programmes experienced. In June we announced some important steps that, when taken together, really unlock liquidity for our clients that had been locked up because of longer duration securities in our collateral pools. Our model for lending is different from our competitors because we combine the best of integrated lending and re-investment with the best of outsourcing re-investment. The credit team within our reinvestment programme is dedicated to money markets, which is a competitive advantage for our clients. Finally, I think going forward lending mandates will not stick to a defined formula. Agent lenders will have to deal with client managed cash, non-cash collateral and other non-standard structures. This flexibility will have to extend to pricing structures, guarantees, and alternative forms of collateral.

Chris Kunkle: In the business (remember, we are an association) two things occurred. First, the methodology of lending has become more intrinsically driven - firms are aiming to get more specials and less general collateral out to borrowers.

Second, firms are continually working to help their clients understand how they are reinvested.

They are taking extra steps to help their clients understand the various benefits and risks of securities lending.

Has the intrinsic methodology removed liquidity from the market? In most cases, what drives liquidity is the availability of special stocks. The fixed income market is flat because interest rates are flat. But for the most part liquidity is still in the equity markets because firms are intrinsically lending those securities. You're not having trouble with large cap stocks, your IBM or your Microsofts. But when you're lending general collateral for a lower rate, that's not specifically creating liquidity. Intrinsic lending is not a bad thing and perhaps this shift makes the securities lending market a bit better.

If there's another market downturn and large cap names start trading tighter (eg, Citi circa 2008) then liquidity could again be an issue in a minority of cases.

Chris Doell: "Over the last several years, in considering our securities lending strategy at Northern Trust, we have really aspired to remain focused on our core strengths and offer clients a stable and rewarding lending experience. At a time when stability and consistency is so difficult to find across the financial markets, we have looked to make adjustments, while avoiding potentially disruptive overhauls, to our securities lending strategy.

This means we have sought out innovative ways to extract the optimal intrinsic value for our client's assets by building ever stronger connectivity with our borrower counterparties. We have expanded our suite of lending markets to take advantage of the globalisation trends affecting our industry, and we have equipped our clients with increasingly powerful tools for monitoring and actively managing the level of risk to be taken in their lending programmes.

These changes are meaningful, but they also remain highly aligned with our long-term identity as a lending agent focused on providing exceptional client service, dedicated to extracting the greatest amount of intrinsic value, and stringently managing risk.

Rory Zirpolo: As we are a matched book securities lending partnership, we do not have exposure to reinvestment risk. Accordingly, the core of our strategy has not changed over the past few years. However, the availability of hard to borrow securities has declined along with overall short

interest in the markets. The combination of investors deploying less capital on the short side of the market and the current near zero interest rate environment has compressed our spreads as well as the strategy's profitability. Looking forward, we intend to expand the counterparty network with which we trade, especially globally.

Karen O'Connor: eSecLending has always viewed securities lending as an investment management function rather than a back office or operational function. With the evolution of the industry since the credit crisis, it is a philosophy that is becoming more prevalent within the market.

We remain committed to our auction process and using it as a tool to help determine which route to market is optimal for our clients' assets whether through agency exclusives or discretionary lending. In addition, we have rolled out a new product in the treasury and financing space, which is designed to support large institutional investors in managing the operations around their treasury management functions, leveraging our securities lending expertise and capabilities.

SLT: How much impact is the Dodd Frank act having on the market? How much work are you having to do internally to ensure you are compliant?

Eelens: It goes without saying that Dodd-Frank will substantially affect all financial institutions, but the degree of impact varies - being particularly tough on big US domiciled banks. Having said that, the bill will ensure that there is less risk based leverage in the financial system, producing however the side effect of creating downward pressure on industry profitability and upward pressure on capital requirements. On a day-to-day basis we are focused on implementing the various regulatory requirements including but not limited to reporting, record keeping, collateral management, capital and liquidity.

Zirpolo: Although we may not be directly affected by the requirements of the Act, we do expect the Act to have an impact on securities lending volumes by virtue of the stricter capital, credit, and concentration limits being imposed on banks and their affiliates.

Sylvester: The impact of Dodd Frank is still unknown to a large degree. The regulation is actually a framework in which various, more specific, rules will be written. At the moment there are still hundreds of rule makings and studies assigned



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to close to a dozen regulatory bodies. JPM is actively working with our government relations group and several industry organisations to keep abreast of the latest developments. Additionally, JPM is consolidating this information and assessing the potential impacts across the range of our products.

Johnson: The continued dialogue that our industry representatives have with the SEC has been quite successful

Seidel: All market participants have been focused on Dodd-Frank this year, specifically in terms of analysing the rules, identifying issues to be resolved in future rule-makings, and clarifying the potential areas of impact on the lending market. There is still significant uncertainty around the impact, particularly as 250 rulemakings are to be completed over the next two years. The largest impact on the market may in fact be indirect - that is, the impact to borrowing demand that stems from uncertainty surrounding the final form of Dodd-Frank.

The current focus is on the upcoming rule-makings, including regulation aimed at increasing transparency in the securities lending market. The study of a mandatory haircut on secured claims, while not currently slated for a rule-making, could also significantly impact the market if it this were to change. Creation of the Orderly Liquidation Authority is probably the most important aspect of Dodd-Frank for lending thus far. While it has minimal impact on a day-to-day basis, the OLA could obviously have a substantial effect on how the securities lending market functions during a time of stress. Given the new provisions, it makes sense for all market participants to do a full review of legal and risk parameters, and for beneficial owners to discuss with their agents how the new rules could impact their programmes in the unlikely event of a default scenario.

Johnson: We are always reviewing the impact of regulatory changes. Our systemic approach and years of experience enable us the flexibility to comply with new rules and requests quickly and efficiently. We built a great foundation with Reg SHO and have the ability to adhere to changes quite simply.

Slater: The Dodd Frank Act has little direct impact on agent lending programmes. That said, we continue to monitor legislative and regulatory developments to better understand how it might affect our clients, borrowers and broader markets.

DePetris: Since we are already compliant with Dodd Frank the impact, by and large, has not been readily observable. However, we expect changes in the wider securities lending market as policy reforms begin to take shape. For example, how formal SEC jurisdiction addressing open regulatory questions should add confidence to the industry understanding of best practices. Additionally, we think the mandate that requires the SEC to promulgate rules for more transparency within two years of the enactment of the regulation will bring meaningful improvement to market quality.

Kunkle: It is certainly groundbreaking legislation, something we haven't seen since after the Great Depression. It's affecting both banking and brokering. So it's having an effect on securities lending, but it's a much bigger impact for banks - I know of some banks that have a multiple-page document, each page having several items explaining the changes.

Last November, the RMA put on a Dodd-Frank forum for the membership, alongside the Debevoise and Plimpton law firm in New York. We invited the SIFMA SLC membership and we had over 100 participants.

Through this July a number of rules have to be in effect, and this will be followed by further implementation during the following year. Banks within the RMA have a pretty strong understanding of what they need to do. Things may change [in the legislation] but they're already working very hard. I think we'll handle it.

The thing about Dodd Frank is that banks have to implement it. It doesn't matter if they're big or small, whether they are affiliates of international banks, or small community organisations. As far as securities lending goes, from an RMA perspective it really only affects about 20 agents. At present, if prepared for, I don't think it's going to put anyone out of business as every bank that does agent lending is of a substantial size.

Doell: Obviously, the entire financial services industry is focused on the roll-out of this new regulation and is watchful of the course it will take. For now, we expect Dodd-Frank will lead to a more detailed framework for securities lending markets than seen before, but it is still too early

to suggest how all those details will ultimately be mapped out.

At Northern Trust, we make sure our experts remain heavily engaged with the various specialist industry associations, such as the RMA (Risk Management Association) Committee on Securities Lending, and continue our direct dialogue with regulators and legislative groups to contribute to these important developments.

SLT: Are there any new regulations coming out of the SEC that will affect your business and what is the SEC's current attitude towards securities lending?

Johnson: The continued dialogue that our industry representatives have with the SEC has been quite successful. Transparency is key to aspects of the securities industry, and both sides have worked very hard towards that.

Kunkle: The RMA is working with the SEC, which is tasked with potential legislation on securities lending and securities finance. There is a potential issue here in that they may be legislating in a vacuum. The Fed and OCC meet with us periodically and we work together. The SEC is very quiet about what its intentions are. While the SEC joins in on our periodic meetings with the Fed, we're looking to meet with the SEC to address its concerns, and to ensure it has a full view of the market.

Bonn: Our clients now have a much better understanding of risk as it relates to securities lending

We don't know if the SEC has started to write new rules, or when it will. We're trying to help assess what it's concerned with. In the US, the Fed and the OCC are really working to educate themselves on securities lending. We have twice done training for the OCC for example, and once for the Fed. And we do have an outreach programme where the SEC is always invited to participate. The SEC is trying to learn - we put on an



academic forum each year with the University of North Carolina - it brings in experts from Harvard, Yale and Wharton - and the SEC attends in some capacity usually.

We know that regulation is coming and it may benefit the industry in some areas. But we have to be careful not to over-regulate and make ourselves uncompetitive compared to other markets.

Eelens: It cannot be stressed enough that although there are benefits to a cash reinvestment programme, it should be considered separate from securities lending.

Zirpolo: There has been increased scrutiny from the SEC and FINRA with respect to fully paid securities. Specifically, a number of additional regulations have been implemented to increase the level of disclosure provided to clients.

Sylvester: Under Dodd Frank, the SEC was tasked with rule making regarding securities lending by July 2012. The rules are intended to increase transparency of information relating to securities lending to brokers, dealers, and investors. Further specifics around the rule making request were not defined and at this point, the SEC has not given any indication on what the final rules will look like or focus on. As noted above, we continue to have discussions with various industry and internal groups to assess developments

Seidel: BBH is monitoring a few key regulatory areas, and right now focus is on the rules implementing the Orderly Liquidation Authority, the SEC's upcoming rule-making to address the transparency of information available within the lending market, and the anticipated FSOC study of a potential haircut on secured claims.

The SEC is required to finalise the transparency rules by mid-2012, so we anticipate a draft rule sometime this year. The study of a mandatory haircut on secured claims is not currently slated

for rule-making, but could also significantly impact the market if this were to change. The industry will also be monitoring what new capital burdens may be imposed as a result of Dodd-Frank's express requirement for regulators to address the risk that lending activity poses to the economy as a whole. Of specific concern will be whether the capital requirements of Dodd-Frank will be additive to those expected under Basel III, or whether there will be a coordinated approach to additional capital rules. As always, it will be critical for the industry to stay informed about the upcoming rules and to provide insight to the SEC and other regulators about how the proposals could impact the market. BBH continues to stay engaged with regulators through our involvement in the executive committees and boards of RMA, ISLA and other industry associations.

Eelens: There are no specific regulations that we feel will be prohibitive to our business. The SEC recognises securities lending as a liquidity provider and its importance in maintaining an efficient overall market place.

SLT: What enhanced risk management measures are you now taking and how are these holding up? What does the risk/return profile look like?

DePetris: From the outset, we have processed all of our transactions through a Central Clearing Counterparty (The Options Clearing Corp). In our view, the CCP model is the standard for risk management practices as reflected in their high credit ratings (OCC is a AAA rated entity). We are excited to continue delivering the best possible risk management platform to our customers via the CCP platform.

Doell: Given the intensity of the global financial crisis, our team responded with several measures designed to enhance awareness of risk for clients and actively manage and control the overall risk of the programme.

We focused very early on transparency—immediately rolling out several new tools for communication and outreach to our clients and their consultants. We enhanced our credit risk management practice to provide an independent model for assisting our portfolio management teams with decisions surrounding cash collateral reinvestment strategies, including legacy portfolio holdings inherited as part of transitions from other providers.

And we were receptive to client and consultant

feedback in developing new investment guidelines for clients – they told us what they would like to see, we listened, consulted with our portfolio management experts, and implemented those guideline changes where appropriate.

These changes were greeted positively by our clients. Today, we find the resulting risk/return profile is highly aligned with client expectations, and our clients tell us they are gratified to have the ability to help customise their participation to fit their specialised risk and return objectives.

Johnson: Credit risk is always a challenge, but we have very competent individuals that drive that function. Using the best tools available within the industry is a must. We are always on the hunt for better ones, to provide us with even more insight to all elements of market and client risk.

Slater: Following the events of 2007 and 2008, clients have reassessed risk appetites. This continues to drive client requests for enhanced reporting and risk/performance analytics. In some cases, clients are tailoring guidelines in such a way as to lower their reinvestment risk while accepting lower returns.

O'Connor: We recognise that not all clients have the same risk profile which is why we treat each client as a separate programme

Zirpolo: In addition to traditional credit analysis and risk management techniques like diversification and active credit monitoring, we have isolated counterparty default risk as the main risk factor that gives securities lending its risk premium. Much of that analysis has centered around loss given default. We are more conscious than ever before about borrowing assets that either reduce that number or add the most value to our book. But being a majority match book business, we couldn't be more excited about our risk/return profile, which has a positive expected value and a very tight distribution – not unlike that of the cash markets.



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Seidel: Despite the challenges faced by many investors and by the securities lending industry as a whole, the BBH securities lending programme has performed without incident. While many other lending providers have re-evaluated and modified their programme strategy and risk management practices based on recent market events, the BBH strategy and philosophy have not changed since programme inception and are now resonating more deeply with our clients. We are committed to providing industry-leading returns to our clients while still adhering to our fundamental priorities of risk management. By striking this balance effectively, we have successfully navigated recent market events that adversely affected many other securities lending programmes.

Eelens: Risk management has always been an important component of our programme. Where we previously relied primarily on daily mark-to-market methodology and collateral management, we have expanded our credit management variables to include a market volatility based VAR methodology.

Bonn: Our clients now have a much better understanding of risk as it relates to securities lending, where previously it may have been viewed more as an operational exercise. I would say that securities lending can offer a relatively low level of risk for a relatively moderate rate of return, but it has never been completely without risk. State Street has been investing in risk management staff and products for a number of years now and in 2011 we will offer our clients a standard risk reporting service and a bespoke risk advisory service.

Kunkle: There is a whole new respect for risk management and that has flowed to securities lending. Firms are tightening up their reinvestment guidelines and clients are looking for different solutions in reinvestment. The Fed is looking at agent lenders and how they invest, while companies in and out of securities lending are listening to the market and credit risk people much more than they did three years ago.

I think we always have to be cognisant of what we've done in the past. In the US, we tend to have a short memory. Within securities lending, firms are looking to make sure their clients are protected. I worry about the potential tendency to forget. That said I don't think we'll be back to volume levels of 2007 any time soon.

O'Connor: We recognise that not all clients have the same risk profile which is why we treat each client as a separate programme allowing us to customise based on their specific re-

quirements. We view securities lending as an investment decision and therefore embrace the concept of diversifying exposure by utilising best in class providers across all components of a client's lending programme, including their custodians, lending agents, borrowers, cash collateral managers and indemnifying insurers.

Counterparty risk continues to be an area of heightened focus for lenders which is why we are proactively taking steps to redefine the controls and protections we have in place for our clients. For some clients, we have implemented enhancements to their risk management programme through the use of the CDS market. We monitor borrowers' creditworthiness and we have instituted a dynamic process whereby additional collateral (above the standards of 102 per cent/105 per cent) is required when a borrower's CDS spread reaches a specific threshold.

SLT: After the Lehman collapse a lot of beneficial owners scaled back or withdrew from lending. What advice would you give to beneficial owners now considering doing securities lending/reentering this market?

Siedel: The most important thing beneficial owners can do is select a lending agent whose interests and programme philosophy are closely aligned with their own - Can an agent generate revenue within their risk profile and does it have a history of doing so? What portion of returns are generated from the demand value of their securities versus from collateral reinvestment? Having just come through the crisis, beneficial owners can compare how different agents fared based upon real evidence. For instance, did the agent's reinvestment vehicles contain impaired assets, did they impose redemption restrictions, have they received any lawsuits related to securities lending? The answers to these types of questions will provide valuable information about the philosophy and risk controls of a lending agent.

Zirpolo: There continue to be opportunities for intrinsic value lending which, if combined with sound risk management procedures, earn respectable risk-adjusted returns for beneficial owners.

Sylvester: We've seen new entrants to the market for a variety of reasons. There were clearly lenders who had suspended their programmes and have now re-entered the market. They had a good experience and were educated. In those areas we saw a very healthy trend of increased

scrutiny and oversight from the lenders as a result of the crisis. The new entrants are looking at it from a variety of different perspectives. For example, securities lending might represent additional revenue potential for their overall fund portfolios. The new lenders have read the press, have seen what others experienced and as a result, they are a much more savvy consumer. There seems to be an in-depth understanding of all the intricacies of the programmes.

Sylvester: Clients are far more interested in a dedicated separate account type platform and this is where they determine the parameters governing their reinvestment portfolio.

Eelens: Beneficial owners mostly suffered via means of their cash reinvestment programme, where they built up exposure to Lehman and other questionable credits on an outright, term basis. It cannot be stressed enough that although there are benefits to a cash reinvestment programme, it should be considered separate from securities lending. First and foremost, it is important to look at the intrinsic value of lending your assets, which can be obtained risk free (via treasury repo for example). Second, closely consider your collateral/re-investment requirements. Collateral is primarily meant to mitigate risk and if you want to produce an additional return above the standard "risk free rate" (treasury repo) on your collateral, it is appropriate to consider this as a separate asset class with its own risk/return metrics. Non-cash collateral programmes by comparison offer a great alternative and are too often overlooked by beneficial owners.

Kennett: From a matched book perspective, we see renewed buoyancy in securities borrowing and lending (SBL) markets and in general a positive opinion from those professionals who trade within it. The market is still focused on the after-

math of the Lehman collapse and is much more stringent in controlling limits, both from a risk and a credit perspective. There is an increased amount of transparency in this market which also makes it more controlled. For beneficial owners, SBL has always represented a strong uplift in yield. We would invite beneficial owners to take comfort in the caution that this market now takes in its normal course of business and re-introduce (at least in part, if not in whole) their security portfolios to lending pools, to take advantage of those increased yields again.

Slater: The securities lending process held up very well through the crisis.

DePetris: Our opinion is that the choice to lend securities is no different than any other investment decision – a simple risk vs. reward tradeoff. The problem, historically, was that there were a limited number of routes to market and thus the risk-reward profile tended to be fairly uniform across the industry. However, today that paradigm is changing. Competition has driven entrepreneurs to create new models for securities lending investors and as a result, the routes to market are now fairly diverse from a risk-return perspective.

Additionally, it is widely accepted that most of the historical securities lending rewards (and risks) were associated with cash reinvestment. However, today's models allow for greater yield on intrinsic value and thus de-emphasise the need to chase yield on the reinvestment leg. We think that any platform that can deliver improved intrinsic value returns will be attractive to securities lenders going forward as it affords a better risk-return profile on their investment.

O'Connor: Securities lending is not for all beneficial owners, as each lender must be aware of the risks involved while generating returns. The credit crisis made more people aware that a securities lending transaction, particularly in the US, is comprised of two distinct functions; securities lending and collateral management. For those beneficial owners interested in entering the market, they should work with their securities lending agent to develop a customised programme structure in accordance with their specific objectives and risk/return tolerances. Once the strategy and parameters are defined and the lender and agent are in agreement, agents must work with their beneficial owners to monitor revenue attribution and programme compliance to ensure the imposed guidelines are adhered to and program goals are aligned. This is an important part of programme oversight.

Slater: The securities lending process held up very well through the crisis. Losses that some investors experienced during the crisis related to what the cash collateral was invested in. The amount of risk taken in reinvesting cash collateral is customisable for the beneficial owner. Reinvestment can be analogised as a risk v. reward continuum. Programmes can be structured with varying degrees of reinvestment risk. Clients should consider their revenue expectations in conjunction with their risk tolerance.

Bonn: We spend a great deal of time working with our clients to ensure they completely understand their securities lending programme and what level of risk they are comfortable with. The advice I would give is to educate yourself and ensure that the firm you are working with is able to provide you with the level of transparency and risk management and reporting that you require. Doell: We feel it is an opportune time for institutional investors to review their securities lending opportunities and determine if a program can be built that suits their risk and return objectives. For organisations evaluating whether to start or expand their lending activity, our advice is to work with an experienced agent like Northern Trust who will take the time to offer a guided tour of the global opportunities available based on their specific lendable base.

Chances are, there are certain assets in each investor's holdings, which are of great value to the borrower community, and we can help clients seek out opportunities to capture the premium borrowers are willing to pay for this access. With all the risk monitoring and management tools available to clients today, providers like Northern Trust are in a great position to help build a programme tailored to meet each client's specific risk tolerance.

O'Connor: Securities lending is not for all beneficial owners, as each lender must be aware of the risks involved

Kunkle: The mutual funds, pension funds and public funds that stopped securities lending did so before the crisis hit because of the short selling restrictions that were introduced in the US. That got a small set of clients nervous, but for the most part lending was reactivated before, even during, the liquidity crisis.

While some funds had collateral reinvestment issues, a majority of clients that temporarily ceased activity have returned to the market. Again I don't think we will see the levels of activity that we had in

2007 because they are lending more intrinsically. Having serviced clients at Wachovia and J.P. Morgan [before joining the RMA] it does bother me that some of these clients seem to have temporary amnesia. I know that when I was at those banks, we thoroughly went through the reinvestment process with the clients.

So then I see an article about certain clients not understanding the risks in securities lending I get somewhat perplexed. There are examples of pension plan heads that have been attending industry conferences such as IMN's Beneficial Owner's Conference for many years. These same people have spoken as experts on securities lending and its risks at these same conferences.

Then the same client, who is mentioning himself/herself as an expert speaker, has a loss incurred by participating in securities lending and they seem to have temporary amnesia. They blame the agent lender, the business in general and everyone else, but they don't speak about how well the business has profited them over time. Then they decide to show up at the next conference as a panelist/expert on the securities lending business. Seems off to me, but it's happening at present. I feel that we as an industry need to "call these people out."

On the other hand there are some people who do need education and help. And for those persons, RMA provides educational classes on Securities Lending (SL101-301).

SLT: What can we expect overall borrower demand for securities to be in 2011? How would this compare to the last two years?

Kennett: From a US domestic perspective, the market has been stand-offish while it gets more comfortable with ever changing short sale rules and costs. The market also is being affected by a lack of M&A deal volume and caution around specific yield enhancement plays in 2010. To a degree, that was also the case in Europe. In 2011, the US and European markets are poised to show greater volume, however. Demand in Asia has continued to be strong. As a result, the loan pools often dry up, and would benefit greatly from restocking. The last two years have seen this market still very much in the aftermath of the Lehman collapse. But as we move away from that and see more robust control and transparency, I believe that confidence and demand will increase.

Zirpolo: We see borrower demand increasing, as underlying hedge fund clients slowly take the brakes off of deleveraging.

Also, with investors more aware of risk than ever before in traditional asset classes, we see them flocking to hedge funds in search of above average returns. This should cause trading volumes

to increase from their lows in 2008/2009 on platforms like Equilend.

Sylvester: 2010 has been a year where most of the factors that could collude against you did so: oversupply in the bond markets, quantitative easing, lower dividend yields, lower hedge fund activity, and minimal M&A and IPO activity. Many of the headwinds came together and impacted at the same time. I don't think 2011 is going to provide a vast amount of relief. There may be more positivity on the equity side but I wouldn't suggest it's going to be substantial.

But it's interesting how the market adapts to these situations. Right now, for lenders willing to lend bonds for more than a year, there is the potential to substantially improve the return. This is because the banks are very keen to borrow securities for longer than a year given new capital requirements coming out of Basel III and other regulatory requirements. Different enhanced revenue trades do exist in the marketplace today for those that are willing to take them up.

But overall from a lending perspective, the recovery has not happened. We may see a modest recovery in 2011, but there is going to be continued pressure on the P&Ls of many market participants. As a result, you may see a classic two tier market, with three, maybe four, very large, dominant providers and a number of niche organisations. Everyone will have their place, but it will be a different, more bifurcated model than it is today. The profitability of the industry will drive that.

Seidel: We expect demand to increase compared with the last two years. Important demand drivers will include hedge fund asset growth and increased leverage, along with increased M&A and convertible bond activity. New markets should open to lending across the globe in some of the emerging economies, and ETF demand should remain solid as it continues to be a cost effective way to access an index.

Doell: today's level of borrower demand is largely consistent with historic norms

Eelens: M&A and capital markets activity is on the rise and we think this will drive an increased number of specials compared to the previous two years. However, given the current Fed fund rate and a fairly flat short term yield curve, demand will continue to prove somewhat challenging. The need for flex-

ible solutions and deep, multi jurisdictional market expertise will become more apparent.

Johnson: In our opinion there is more supply than usage. The activity surrounds a specific pool of hard stocks of interest to traders. Supply in these names can get tight and therefore rates increase. This has made it tougher and has put pressure on the cost of selling short. We anticipate a constant flow for 2011.

Slater: As global economies and financial markets continue to improve, we are expecting a modest increase in demand for equities and corporate bonds this year. However, the US Treasury market continues to be challenged by near zero interest rates and excess liquidity.

Bonn: The effects of the financial crisis, including decreased liquidity, increased regulation and the deleveraging of hedge funds have changed the face of securities lending. However, the renewed focus on risk and transparency has moved the industry towards new standards, which will transform the way portfolios are built and how risk is managed. We are seeing clients return to the market slowly, although they are typically maintaining more conservative lending programmes. I think it is important to acknowledge that the returns we saw in 2008 were unrealistic and we are working with our clients to adjust their programmes accordingly.

Doell: A lot of the industry's attention has been focused on the decline seen in overall borrowing levels from the peak volumes seen before the 2008-2009 global deleveraging phenomenon. But the fact is, today's level of borrower demand is largely consistent with historic norms – and we observe some signs suggesting that borrower demand is poised for marginal growth in 2011.

The European yield enhancement season typically provides a seasonal boost in the level of demand, there is some expectation of increased mergers and acquisition activity globally, and the degree of liquidity gathered by the hedge fund community simply can't be ignored. All of these factors suggest that the end-users of borrowed securities may look to more vigorously put capital to work in 2011, and that in turn suggests that borrower demand may see a marginal uptick in the near future.

SLT: What issues are being raised by you or your clients as we move forward in 2011?

DePetris: Automation is one area that can always improve from a product delivery perspective, and our focus is to continue to build out new features which make interacting with our markets easier. Additionally, we think it's important to connect the discrete securities lending activity to other linked activities that securities lending touches within a firm like treasury or collateral optimisa-

tion. In general, it is important that our products deliver value to the entire family of related activities within our customer's business. We're constantly looking for new ways to further leverage our products to benefit our customers.

Zirpolo: Regulation, or better stated, uncertainty about potential future regulation, continues to be a hot topic. Our clients want to understand where the regulatory landscape is headed for securities lending in the major markets, if it will have any negative impact on returns and how we can help them navigate the waters.

Sylvester: While we already have robust reporting tools in place, clients are seeking additional ways of looking at the underlying data. As a result, we are increasingly customising reports and as this trend is set to continue to expand, we will continue to invest in this to meet client needs. We believe that this trend, of lenders requiring more information and in different ways, is one that is set to continue.

Sylvester: We may see a modest recovery in 2011, but there is going to be continued pressure on the P&Ls of many market participants.

Seidel: The regulatory environment is obviously receiving a lot of focus as global regulators create rules designed to promote transparency and control. The full impact of the proposed changes is still unknown but it has placed pressure on both sides of the supply/demand equation. On the supply side, it could alter the way large custodial providers approach securities lending, and on the demand side, it will likely impact how prime brokers and investment banks operate. The combined changes will influence demand trends, the economics of the trade and the industry landscape going forward. BBH has been proactive about discussing the proposals with our clients to ensure they understand the impacts to both sides of the equation, but particularly to their individual programmes. This is something we'll continue to do over the course of the year as more information becomes available and more changes are enacted.

Johnson: We are always looking at supply within the industry and the ability for day traders to attempt their strategies on a continuous basis. The more in-demand stocks make it harder to fulfill everyone's requests, and that is something we look at daily.

Kennett: We are also seeing an increased demand in short cover requests in European, Asian, and emerging markets from clients who would normally keep their strategies inside the US. That partly confirms the market opinion that growth is coming in 2011, as investment houses diversify and perhaps even relax their strategies into new markets.

Slater: As in the last few years, the risk to return paradigm continues to be a focal point for many clients as they strive to balance risk, while also understanding the revenue opportunities. How to maximise revenue while limiting risk continues to be the theme.

Zirpolo: we anticipate the more value-added trades to account for a large portion of our revenue

Kunkle: Presently our members are primarily concerned with Dodd Frank, Basel III and what the SEC is thinking. They also want to make sure their staffs and their clients have the best education on securities lending available should those persons wish to avail themselves of such.

SLT: What is your view on the outlook for securities lending for the next 12 months?

Zirpolo: In what is expected to be a near-zero interest rate environment, we anticipate the more value-added trades to account for a large portion of our revenue. However with an expected inflow of hedge fund capital, we expect the market to be deeper than in previous years.

Sylvester: We are starting to see a pick-up in M&A and IPO activity and we are optimistic, particularly if you look at all of the components affecting demand. We do expect some of the triggers to improve in 2011, but to get back to the highest peaks everything has to be back where it was, and that's unlikely to happen for a number of years to come.

Seidel: We expect to see increased opportunity once the regulatory environment stabilises and the economy continues to improve. We expect moderate growth focused in Europe and Asia during the first half of the year, with the US gaining steam in the second half. There should be an increased amount of M&A activity in the US given the large amounts of cash accumulated. Additional clarity on the regulatory front should help reintroduce conviction on the borrowing side.

While the idea of a central counterparty continues, a solution does not appear imminent due to many factors, including indemnification, recall allocation, and credit risk. On the supply side, flexibility and transparency will be prerequisites for beneficial owners. The ability for a lending provider to be flexible and provide a customised programme is critical, and the most nimble providers will be well positioned to gain market share. The trend will continue for more beneficial owners to select lending agents based on their merits and expertise, rather than on custodial or other relationships.

Eelens: In a sentence; customised reporting, transparency, collateral, creditworthiness and platform flexibility are recurring topics.

Johnson: We believe that this will be a year where momentum picks up. The industry has had its changes and more will be forthcoming. Participants are well engaged in the process, and we hope that all these changes will lead to more volume as the year moves forward.

Kennett: We believe this market is poised to show growth this year, driven by a combination of an ever-increasing understanding of why the market faltered before, new controls, and renewed confidence. Even stronger growth than is perhaps expected is in the hands of the beneficial owners and their thinking around increasing the loan pools.

Slater: Aided by stronger financial markets, securities lending opportunities should continue to improve over the next 12 months. We've seen continuing improvement in balances and are seeing positive changes to clients' perceptions of securities lending. Some beneficial owners who exited securities lending programmes during the market crisis have returned and we expect this trend to continue. Overall we're positive about the prospects for 2011.

Kunkle: I'm positive. I think the RMA membership is handling regulatory issues in a productive way. We're working well to continue enhancing our communications and interaction with other associations, such as PASLA, ISLA, ASLA, SIF-MA and CaSLA.

We're putting a real focus on education - our members are sending us their new staff to learn about securities lending and this bodes well for the future. Finally, I'm happy that we are having strong interaction with our regulators. All-in-all, pretty good stuff for 2011.

Doell: We believe that the outlook for the next 12 months will be positive. We anticipate that borrower demand may begin to intensify and see signs that the overall market environment will continue to improve.

The entire industry has watched as a number of institutional investors have looked to limit their securities lending participation in recent years. In

2011, we expect to see a reversal of that trend as participants seek ways to capitalise on the intrinsic value for their securities and demand the sort of tools we have built to help them monitor and actively manage the risk profile of their securities lending programme.

Given our positive outlook, we continue our long-term plans of reinvesting in our business, building key technology linkages to support our borrower and client relationships, expanding into new markets and asset categories, and cultivating a stable and experienced team of leaders to guide our business and develop solutions for our clients.

Kennett: We believe this market is poised to show growth this year, driven by a combination of an ever-increasing understanding of why the market faltered before, new controls, and renewed confidence.

O'Connor: The securities lending market is expected to continue improving and there are several factors that we expect will be positive for securities lending participants including rising dividend payouts, increasing M&A activity, growing hedge fund demand, and additional rights offerings and IPOs. We also expect the continued growth of both supply and demand in emerging markets. There are also factors that we expect are likely to remain a drag on returns such as fixed income spreads remaining at historic lows, uncertainty over the ongoing regulatory changes, and concern over the European sovereign debt crisis and ballooning US deficit.

The securities lending market has changed significantly over the past two years therefore all market participants need to be nimble in responding to the new market conditions. Lenders and borrowers have different requirements and intermediaries have to be flexible in supporting both. **SLT**