

**INTERVIEW WITH JOHN F. GRIMALDI
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As the biggest securities lending market (in terms of volume of transactions) globally how has the current financial crisis in the U.S. impacted the business?

It has been approximately one year since the sub-prime meltdown began and firms (both directly and indirectly impacted) are still dealing with the effects. Investments banks and commercial banks are still trying to manage and strengthen their capital base. They continue to receive infusions of capital from outside investors or have reduced their respective footprint through the sale of non-core businesses or asset sales.

Securities lending participants not directly involved with the subprime markets have been affected by tighter lending markets, heightened collateral requirements on cash (bank) loans, and greater scrutiny from a credit and counterparty risk perspective. Securities lending participants in the U.S. face many challenges and are focused on balance sheet management and overall liquidity in their day-to-day business. As a result, we have seen a return to more traditional financing vehicles (bank loan and tri-party). Additionally, overall collateral management and maximizing the financial return on securities (collateral) have continued to be a topic of discussion and focus.

Will it be necessary for technology to evolve to meet the new requirements the credit crunch presents.

Whenever there is an event that fundamentally changes the marketplace, technology will have to ultimately evolve to meet the new needs of the market. Over the past year the global market has experienced turmoil in the credit markets and in the U.S. we are about to embark on new regulatory changes as the Securities and Exchange Commission (SEC) deals with the naked short selling issue. In addition, the U.S. market place is catching its breath from Agency Lending disclosure (ALD), Regulation SHO and currently working with their European counterparts on implementing the ALD solution for the European marketplace. Technology must continue to move forward to meet these needs. From the credit crunch perspective, the management and effective use of collateral in today's market is even more critical. Market participants need to know how to maximize the use of their global book of collateral. At any one point in time, they want to know whether to lend a security, utilize in a bank loan, pledge as part of a tri-party arrangement or simply return it to a lender if it was previously borrowed. Technology needs to provide solu-

tions that make the necessary information available in real time so the trader can make an informed decision.

You have mentioned in the previous question/response the imminent regulatory changes regarding short selling. Did your clients face any operational burdens in complying with the SEC's recent temporary order that called for more borrowing of the shares of 19 financial stocks?

Of course. The temporary order was a change to the way business was conducted. It required manual intervention where system solutions were not available. The market participants needed to manually intervene to pre-borrow securities for short sale requests on trade date, monitor executed trades from trade date to settlement date to insure deliveries in the marketplace occurred, as well as, determining when to return borrowed shares. In addition, participants experienced increased financing costs as it relates to the pre-borrowed shares. Most operations and systems were geared around locating the stock on trade date, having their system record the fact that the stock was located, and subsequently recommending a stock borrow on settlement date of the trade if required. Requiring a "Pre-Borrow" or an "Arrangement to Borrow" was not systemically supported in many shops, especially the arrangement type transaction. In addition, both have financial implications, and more importantly the ability to pass those costs to the ultimate borrower (the seller of the security) in an automated method does not exist in most firms today.

Having gone through that exercise, would it be more or less difficult for these firms to comply if the rule reappeared and applied to all stocks?

I believe more difficult, given the current volume of business and level of technology that currently exists in the marketplace today. It is one thing to manually put in place procedures to process and monitor 19 securities; it is an entirely different ballgame if the expectation is to impose pre-borrow requirements for an entire market. I believe the SEC will ultimately end up somewhere in the middle. Proposed regulatory changes will be phased in to allow the market participants to put in place the necessary procedures and systemic solutions to handle any new requirements. One of the ongoing concerns is to reduce any settlement failures in the marketplace. Regulation SHO was implemented to deal with settlement failures and has been effective, but maybe it will require some more teeth. Requiring a pre-borrow or an arrangement to borrow to the threshold list may be the place where the SEC starts to impose the new requirements. Who knows that's just one man's guess!



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