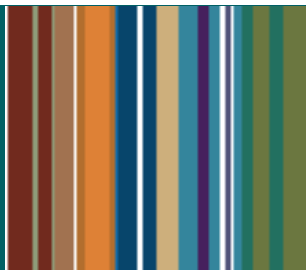




SUNGARD SECURITIES FINANCE



WHITE PAPER SERIES

Transparently Different





There has been a general thrust within the capital markets to take a holistic approach to well... everything! The intention behind this is to increase transparency and lessen the risk for the system as a whole.

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Now in certain areas, this thirst for greater transparency is definitely a good thing. Indeed, one can only surmise what might have been if the industry had had cross-silo transparency or an understanding of systemic risk three years ago, before Lehman's collapse.

But sometimes this headlong quest towards transparency nirvana can have unintended consequences. Each industry sector, country, business and regulator has a different view as to what is meant by transparency and what area should be prioritized. This dilemma is particularly apparent in the securities finance world. Is it possible to establish a baseline matrix? Without clarification and understanding, it will be difficult for regulators such as the SEC to create a mandated roadmap for transparency requirements, and the result could be the demise of what has always been held up as being a major and beneficial lubricant for the financial system.

There are three types of variables that need to be examined, from the macro to the micro. Let us examine each of these in turn and consider how they correlate with transparency.

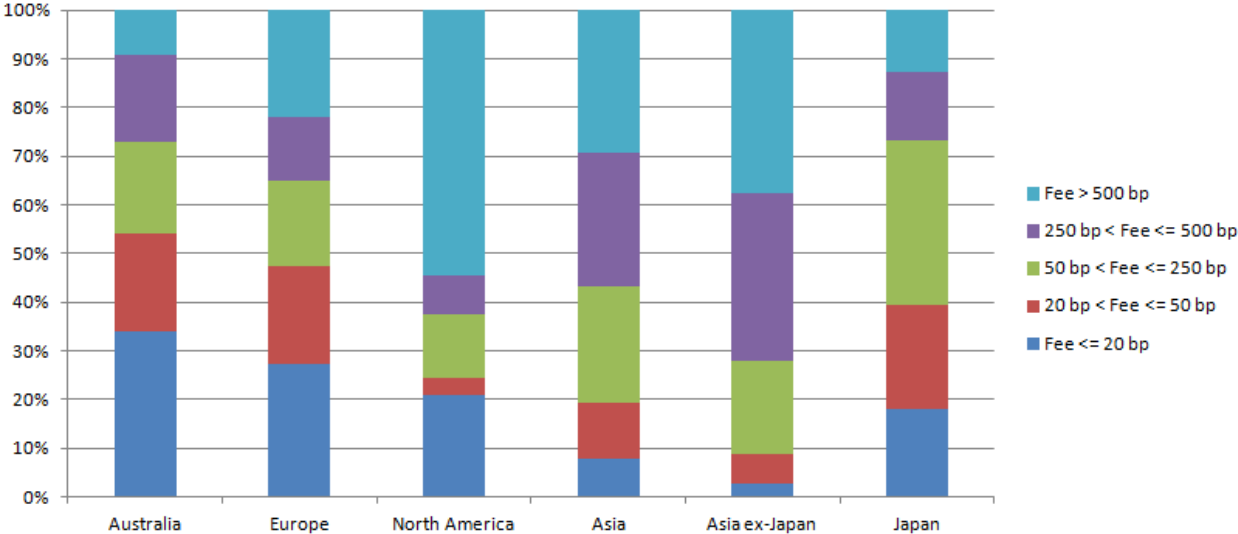
Global Translucence

If you look at a delegate list from any of the major securities financing conferences, you'll quickly recognize that this is a global business. But it is not a homogenous one. There are differences among regions, within regions and across countries.

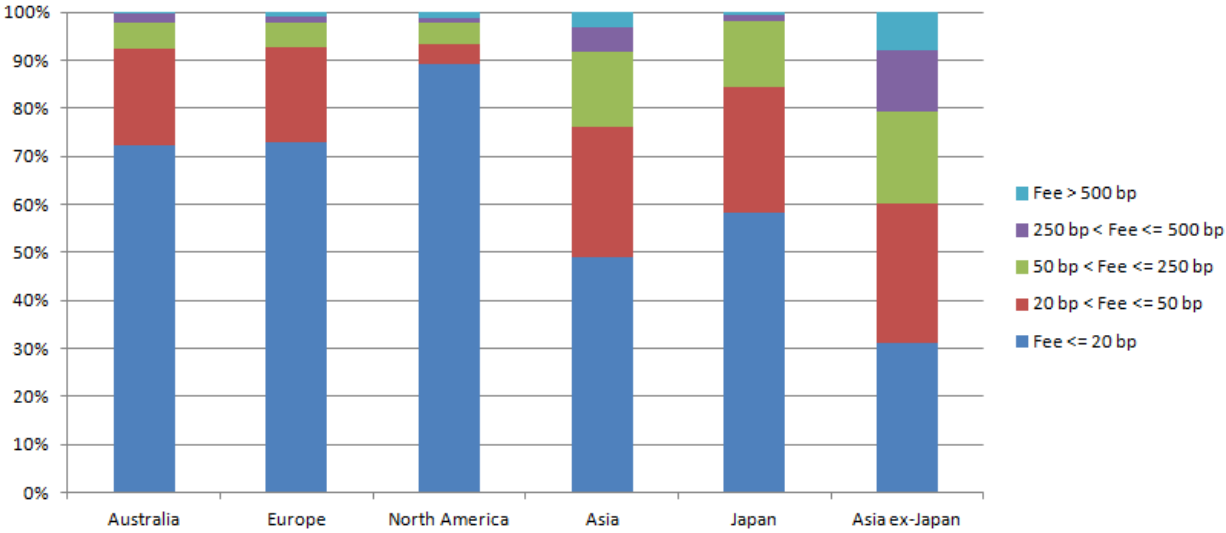
For example, while transparency into the spreads for Special versus GC has received a lot of attention over the past few years, the whole GC/Special debate is not that relevant for the non-U.S. markets. Outside of the U.S., the business is predominantly non-cash, and securities are lent for their intrinsic value rather than what you can do with the cash. Most borrowing is done because people want it – hence the name "special." The GC loan to create cash to re-invest is still a difficult concept for non-US participants to grasp or even understand.

As shown by the following charts, the Special activity – in terms of both balance and revenue – is very different within each region. The differences are even starker when you break out some of the more mature markets within those regions.

Revenue



Loan Volume



Considering these differences, it is not surprising that transparency requirements also vary. In general, the calls for transparency have been focused very much on the risk aspects associated with collateral and particularly the risk of what is done with the cash collateral. This discussion is not really relevant for the non-U.S. markets.

And while there has been a debate around collateral in the other regions, this has been focused on the different types of non-cash and the correlation between the securities being lent and the securities taken as collateral, not on the return on any cash re-invested.

Even though the U.S. is still the biggest market in the world, this is a reminder that there are other markets to consider.

Business Line Differences

The regional aspects aren't the only elements of conferences to change. There have been business scope changes as well. They used to be securities lending conferences and repo conferences, and never the twain did meet. Nor did the participants intermingle. If there was the occasional foray into one another's camps, then the interlopers were confused and had to bluff their way through the alien world they had entered. Even the definition of the term "collateral" varied: for one person it meant the securities or cash taken as collateral for a security being lent. For the other, it meant the securities lodged as collateral for the cash being lent.

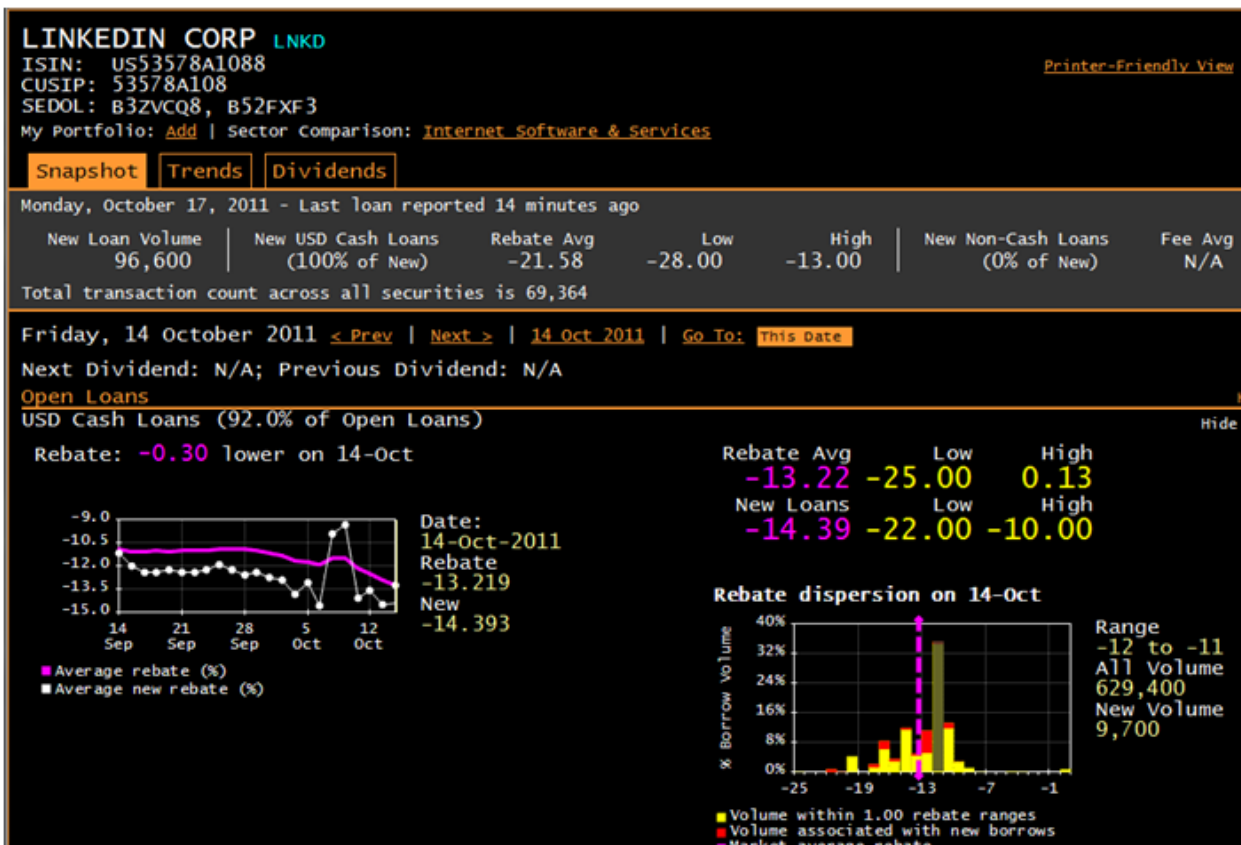
Over the years, the push to homogenize the approach, vernacular, systems and processes has meant that attendees at conferences have become one amorphous mass, like a flock of starlings swirling through the sky at twilight. However, the underlying differences still exist. As a result, when general concepts like transparency are

discussed, confusion can sometimes reign.

For example, it is assumed that because the rates in the OTC securities lending market are very widely dispersed, there must be a lack of transparency. After all, rates in other "trading" activities, such as repo, are readily available on a virtually real-time basis. As securities lending is part of the capital markets and repo business – in fact, some say they are practically the same – then it must be a desirable goal to increase transparency and provide tradable rates for all to use.

Once again, we see a disconnect between the true benefits of transparency and the perceived benefits. Certainly, up-to-date, even intraday or real-time streaming data would give securities lending professionals a better handle on "where a security is priced." But just because the data is available doesn't mean that the rates are drawn to the middle. This is because securities lending is not a trading activity, so it shouldn't be treated like one. The securities being lent are not the same as those being bought or sold, even if they have the same CUSIP. There are differences in size, duration, collateral lodged, dividend requirement, counterparty rating, etc. Furthermore, a securities lending "transaction" can be canceled, amended, partially returned and re-rated at any time during its life cycle.

The example below shows the "spread" in rates between one day and the next, with the data being available to the "arrangers" (used in place of the word "traders"). Yet the dispersions remain. The data below the grey box shows the rates as of yesterday's close, and the data in the grey box shows the rates as of right now. Clearly, the dispersions exist on an intraday basis, even when participants know what is being "arranged." Greater transparency, similar to that created by a traditional trade reporting tool, still does not shrink the range of rates, due to the variables listed above.



Consequently, the urge to have transparency of rates so as to achieve some form or "price" point for "trading" is not really practical nor, some would say, desirable. Trying to make two different arrangements equal is, in a way, manipulation. For example, the intraday price information available through SunGard's Lending Pit is not there to "set" the market price. It is there to provide another data point to help lenders and borrowers make decisions. This is not the same for other business lines.

Similarly, it is a generally held belief that the introduction of central counterparties (CCPs) will tend to bring the rates to one as they create an open "trading" environment. As explained above, the dispersion is driven by multiple variables, and just as the introduction of real-time data doesn't make a significant difference to that dispersion, neither will the interposition of a central entity. The definition of transparency that is used in trading businesses does not work in securities lending.

Stakeholder Focus

There are many stakeholders in the securities financing food chain, and each has a different perspective on transparency.

- **Corporate** – Usually the unmentioned stakeholder in the securities finance process, the corporate entity whose shares are being shorted, borrowed and lent has a keen interest in certain types of transparency. Firstly, they want to know what the market sentiment is towards them and entities like them. In addition, if securities lending transactions show a significant amount of shorting interest, then they are usually interested in knowing who is shorting them to such an extent.
- **Beneficial owners** – The beneficial owners' transparency priorities continue to change. In the past they have been interested in transparency around voting rights, indemnification and splits with agents. Then they focused on legal agreements, investment risk, the fair allocation of transactions and income, and indemnification. The waters are further clouded by the location of the beneficial owner. Regulatory pressure – whether perceived or actual – on those responsible for their members, pensioners, investors or the like to better understand their programs has led to a greater demand for transparency into the process and even trading activity down to the security level.

- **Agent lenders** – The agent lenders’ priorities have changed as well. They are interested in a leveling of the playing field through transparency around the rates to be charged and market levels, as well as the legal process surrounding buy-ins. Since 2008, transparency surrounding counterparty risk has also been important to them.
- **Broker-dealers/Prime brokers** – Often said to be the stakeholders with the most to lose from transparency, they have moved towards greater acceptance of transparency. In fact, they now seek transparency into counterparty risk as well as up-to-date rate information to help them cut the cost of borrowing and reduce capital usage.
- **Proprietary trading desks** – Internal clients have been the main source of income for many securities financing areas. There is a growing demand for more detailed information on the cost of borrowing securities, especially as the debate over spinning off prop trading operations continues.
- **Hedge funds** – Hedge funds have shifted from seeking to understand the costs of borrowing – after all, they want more market and trending information – to information about both borrowing and lending rates. Access to the ultimate lender through arguably transparent mechanisms such as central counterparties has attracted their support.
- **Regulators** – They believe that transparency is a pre-requisite for good governance and stability of the financial marketplace. Regulators have put securities lending on an equal footing with short selling, repo and derivatives trading. As a consequence, the competitive and reward-based elements are not a priority on a global basis for all regulators; their role is to protect and serve, not to assist participants in making money. The exception to this rule would be the desire to have better transparency into income splits between fund lenders and their agents so as to ensure a level playing field.

The Transparency Matrices

Given this multiplicity of interest, motivations and requirements, how can one possibly judge transparency in the securities finance market?

If it is accepted that there are two aspects to securities financing – risk and reward – then it is a natural corollary that there are two key variables when analyzing the desire and effect of transparency. These differences in emphasis go a long way in explaining why so much confusion continues to surround transparency.

The Risk Transparency Matrix

	Legal	Operational	Counterparty	Market	Collateral	Reputational	Systemic	Reinvestment
Regulators						X	X	
Corporates				X		X		
BOs	X				X (Non US)			X (US)
Agents		X						
BDs			X		X			
HFs		X		X				
Public						X	X	

The Reward Transparency Matrix

	Rate discovery	Split	Market signals	Performance benchmarking	Investment management	Collateral optimization	Market movements
Regulators		X	X				
Corporates			X				
BOs		X		X			
Agents	X			X			
BDs	X					X	
HFs			X		X		
Public							X

Conclusion

One of the ironies about the transparency debate is that everyone is absolutely unambiguous as to how they define transparency and what needs to be more transparent. But it is not so easy, or so obvious. The differences across geographies, business units and stakeholders mean that the industry needs to understand and agree that each area or group may need a different level of transparency. Transparency may be portrayed as a panacea for all ills, but the old adage that “to know all is to understand all,” without exception for competitive advantage, may end up undermining the whole system.

About SunGard Securities Finance

Customers all over the world rely on SunGard to fulfill their securities finance business needs. SunGard provides a comprehensive suite of securities finance solutions: from trade initiation through to final return; including order routing, trading, position management, collateral management, operations, accounting, settlement, transaction analytics and benchmarking and trade automation services. With over 20 years experience SunGard has a global linked community of securities finance users. 17 out of the world's top 20 banks use one or more products from SunGard's suite of solutions for securities finance.

For more information, please visit www.sungard.com/securitiesfinance.

About SunGard

With annual revenue exceeding \$5 billion, SunGard is ranked 472 on the Fortune 500 and is the largest privately held business software and services company on the Forbes list of private businesses. Based on information compiled by Datamonitor*, SunGard is the third largest provider of business applications software after Oracle and SAP. Continuity, Insurance & Risk has recognized SunGard as service provider of the year an unprecedented five times.

For more information, please visit SunGard at www.sungard.com.

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