

EquiLend Rides Growth Curve

As in other financial product areas, automation has promoted and supported growth in the \$1.5 trillion global securities finance market. At the same time, the market is coming under unprecedented regulatory scrutiny since last year's implementation of the Securities and Exchange Commission's Regulation SHO and the impending Oct. 1 deadline for the final phase of the agency lending disclosure initiative.

One of the technology providers responding to the challenges of automation and compliance is EquiLend Holdings, a consortium formed in 2001 by 11 major firms—Barclays Global Investors, Bear Stearns & Co., Credit Suisse, Goldman Sachs Group, JP Morgan Chase & Co., Lehman Brothers, Merrill Lynch & Co., Morgan Stanley, Northern Trust Corp., State Street Corp. and UBS—to develop and operate a global platform for securities finance transactions. The New York-based company was organized as a broker-dealer in the U.S. and an alternative trading system in Europe, and it entered a technology niche that had largely been dominated by SunGard Data Systems and its Loanet and Martini products.

The regulatory scrutiny is coming partly because of the close association between securities lending and short selling by hedge funds. The conventional wisdom is that regulation is a much-needed corrective to activities that add to market risk, but that doesn't reflect the reality of securities finance, in the view of EquiLend CEO Brian Lamb. He says the business grew out of a need to address failed settlements, which were a persistent problem as recently as the

1980s. As securities finance became more widespread, fails became less of a difficulty and liquidity and efficiency improved for the capital markets as a whole. Says Lamb: "It's a big story that's often overlooked—the efficiencies and liquidity that securities lending brings to bear."

Lamb spent 17 years with Barclays Global Investors before joining EquiLend last year to succeed Dirk Pruis, the platform's head since its inception. (Pruis left to become VP of advancement for Calvin College in Grand Rapids, Mich.) Lamb's last position at the Barclays unit was head of global derivatives services. Before that, he was product manager for fixed-income securities lending. In 2001 and 2002, he and Pruis, who was a VP in the technology strategy department at Goldman Sachs, co-led the project to get EquiLend off the ground. Lamb recently discussed the securities finance market and his company's place in it with *Securities Industry News* managing editor Joseph Radigan.

What distinguishes securities lending from securities finance? Securities finance is a broader description of the business. It encompasses both securities lending and securities borrowing as well as the other, underlying financial transactions and financial dynamics that accompany them.

What prompts a market participant to borrow securities? At the most basic level, someone borrows to cover a short position or a fail, which has to do

with the delivery of securities. Suppose you call up your broker, and you want to buy some shares of Cisco. If that trade is supposed to settle in three days, but the seller isn't able to deliver those shares, that would be a fail, and the seller would



generally look to borrow the securities until the fail is covered. Fails are a big part of the marketplace, and 20 years ago they were a big problem. Securities lending solved that. Without it, you would have a less liquid market with less efficiency that would have higher costs for all investors. Someone would have to pay the price for that inefficiency.

What are the growth prospects in U.S. securities lending? I expect the securities finance business to continue to grow at its current pace [15 percent to 20 percent annually], if not faster.

How does the U.S. compare with overseas markets? The U.S. securities finance market is the largest, closely followed by Europe and Japan. But I think the rate of growth will pick up overseas, because there's more room for growth. There are local dynamics that lead to people wanting to finance securities to a greater degree, but there are also global trends, such as the proliferation of hedge funds. Hedge funds will look for alpha wherever they can find it, and that is certainly contributing to the growth we've seen.

What role do automated tools play in helping the industry manage this

growth? Without those automated tools, the market would be less efficient, and costs would be higher. They allow people to create scalability so they can manage more business with the same amount of resources and help contain costs and mitigate risks. Our platform was built by the industry for the industry. These tools are all about making this marketplace a more efficient place to do business.

What effect has automation had on risk management? Efficiencies help to mitigate risk. From the EquiLend side, with trading, we have a shared trade ticket. A deal is not consummated if certain mandatory fields are not matched. If things aren't matching, that's where you have risk. With products like our comparison services, on the day after the trade, we help people find mismatches. In the equity securities finance market, the billing process is monthly, and we help clients focus on places where their bills may not agree. Automation is all about creating efficiencies and mitigating risk in the process. We offer other services for our clients when they trade off of our platform, and we allow them to apply the same rigorous standards. That allows you to focus on the risky part of the business.

How prepared is the industry for the Oct. 1 agency lending disclosure (ALD) deadline? I think the industry is making good progress and looks likely to be ready. EquiLend will certainly be ready in advance of it. There's a lot of testing to be done, so now through August and September will be a busy time. Some players are likely to be less ready than others. But from the beginning, there have been people who have taken it very seriously and focused a lot of resources on their systems and interfacing their proprietary resources to services like EquiLend.

What challenges does the market face in meeting the Basel II capital standards? Because there are some challenges and dynamics that are similar to ALD, there has been some thought that market participants may try to learn from what's been accomplished there. Some of the global firms would rather have one way of calculating capital adequacy and credit exposure. Then they'll see what they have to implement for Basel II and to what extent they can use the same model they had for ALD. There are also industry bodies, such as the International Securities Lending Association, Risk Management Association and Pan-Asia Securities Lending Association, which are helping to inform decisions. When the time is right for EquiLend to participate in those discussions, we will. We will add our resources to solutions just like we did with ALD.

How does the confluence of ALD, Basel II and Reg SHO affect a company like yours? To some extent, the regulatory attention has always been there, but it hasn't been in the public domain. The regulatory component of this business continues to evolve, and as it does, we find ourselves at the center of these issues. We're owned by 11 of the largest financial institutions. They want us to contribute to the solutions to these initiatives. One example is our contract comparison upgrade. It's not a direct correlation to a regulatory initiative, but it certainly goes a long way to help our clients control costs and create efficiencies that allow them to focus on regulatory initiatives. It helps create a level of transparency that regulators are often looking for, perhaps a level that wasn't there previously.

Apart from the push to automate, how has this regulatory pressure altered business practices and due diligence on transactions? It's on a case-by-case basis. I can only speak from personal

experience. I call it an opportunity to alter business practices and improve them. The opportunity to implement best practices was always a goal at Barclays. I think that's the case for other participants, too. A platform like ours allows them to do that more easily.

What are the challenges in extending automated tools to asset classes beyond equities? One problem is that the people you may be speaking to at a firm's fixed-income department may be different from those on the equities side, and they may not be as aware of a service like ours. There are different conventions in the fixed-income business versus equities, and securities finance tends to be different, too. At some firms, there's a different type of technological dynamic for asset classes other than what you have with equities. A firm may have a proprietary system for equities that may be different from their proprietary system for fixed income.

Do you plan on introducing products for derivatives or commodities? I spent time in global derivatives services, and I see securities finance very broadly. There are applications for the synthetic part of the marketplace. But at this time, we've got enough work in front of us, and we're not considering branching out into those other asset classes.

What's the biggest difference between being a technology supplier as opposed to an end user? As an end user, my focus was on how to use this technology to the advantage of my company. As the supplier, my focus now is on meeting the needs of all of EquiLend's partners and their customers. It helps to have the background I do, because I'm sensitive to the needs of all these market participants. It's challenging, but it's the interesting part of the job to meet the needs of not just one firm. ■