



Asset International

Global players plunge into securities lending

Global trading, with its quick turnover needs, is transforming international securities lending into a growth area, writes our New York correspondent.

A spate of new players - generally custodial banks with a global presence - are now actively moving into the business, particularly in Japan, and looking to act as agents between borrowers and lenders. They include Chase Manhattan, State Street, Security Pacific, Bankers Trust and Bank of New York, officials at these banks confirm. Moreover, sources say that a totally new player, American Express,

is looking at ways to break into the business. According to Bank of New York SVP Thomas Price, an international securities lending operation will soon become "part of the requirement of being a full-service organization."

A number of institutions independently of banks have been acting as lenders to the ever-growing ranks of securities firms that need to borrow securities to conduct their business abroad. The best-established lender is the College Retirement Equities Fund, which has been involved

with securities lending since 1983. Diane Axelrod, VP of administration and trading at CREF, says that in 1986 CREF made some \$7m in profit from lending and "more than half" of that came from international lending. Axelrod adds that the size of CREF's international portfolio (some \$3 billion) and hence the size of its loans make the business worthwhile.

CREF has long eschewed using an agent like a custodial bank, she says, because "with an agent you lose control" and run the risk of interfering with managers' ability to trade. "We're aware of the fact that there will be more supply soon [in international securities lending]," says Axelrod. "But that's healthy."

Other institutions - including the Common Fund and a number of endowment funds - are also involved in international securities lending. A number operate through First Capital Strategists, a Pennsylvania-based group which assists its clients in securities lending, which partner John McCollum described as "another form of arbitrage."

One of the principal challenges for a bank in setting up an international securities lending operation is establishing a network that allows participants in the process - borrowers, lenders, custodians and agent banks - to communicate directly. According to Cindy Gall, who Security Pacific hired three months ago to institute an international stock loan and borrow operation, the key to success is systems support, with rapid communication between brokers and agent banks. As of now, she says, there is no one such product that can adequately serve the

needs of the business.

However, a number of electronic systems companies are looking to deliver a product that fills this niche. One is IP Sharp's Blend, which is already being used by a number of brokers. Financial Telecommunication (Fitel) is also entering the market within the month with a product for facilitating international borrowing and lending, and by the end of the year hopes to introduce a system that will function as an electronic middleman, allowing borrowers and lenders to meet with anonymity. "If and when we can get it out there," says Geoffrey Heal, Fitel executive director, "we know we'll sell it well."

Chase, the largest global custodian, is one of the banks that is determined to enter the international stock loan business. It has a pilot program scheduled to kick off in the fourth quarter of 1987, according to Gerald Tamburro, second VP. "In the next year you'll see a boom in this business," he says. "As for potential size, I can't think how big it could be." Tamburro says that Chase will utilize an in-house communications system, and will market the product through the bank's global custody relationship officers.

Many of the institutions are interested in lending internationally have prior experience in domestic lending. The demand for international stocks from borrowers is potentially even higher than on the domestic front, however. This is because more complicated settlement and clearing procedures outside the US mean that often brokers don't have the stocks at hand that they need to deliver. Moreover, says Tamburro, whereas brokers often hold large portfolios of US stocks for their own

account, this is frequently not the case for non-US stocks.

Another substantial player in the business is State Street, which has for some time "been doing securities lending business for a couple of clients" in Japan, according to Ron Golz, executive VP. At the current stage of the business, says Golz, most custodians tend to act simply as vehicles to "support the receive and deliver functions" of global securities lending. However, he says it is developing in the same ways it did domestically, and banks will play an ever-increasing role in bringing together borrowers and lenders.

State Street "is in the process of evaluating its systems expansion," according to Golz. But he advises newcomers to proceed with caution, noting that this is clearly not a riskless business.

Certainly the domestic example offers evidence of this. Many of the institutions worst hit when California broker TP Richardson went belly up in the early 1970s - taking with it huge portfolios of borrowed stocks - are those now looking to get involved in international stock lending. Golz's advice? "Only lend to brokers with high capitalization." Adds Bank of New York's Price: "The critical ingredient is 'know the borrower.'"

There are other restrained voices, too. "We have done a little lending internationally, but we're being very cautious about it," says Verne Sedlacek, CFO of Harvard Management. "There are implications, like the question of taxation of dividends, that no-one really understands. There is a huge amount of demand, but the risks increase substantially when you're lending securities in markets outside the US."