According to the World Bank, emerging/developing markets enjoyed real GDP growth of around 6% in 2005, with an even greater rate of expansion projected in the coming years. This, coupled with rising levels of capital flowing into these countries (notably Brazil, Russia, India and China) means that Institutional Investors looking to maximize the value of their portfolios should assess the revenue-enhancing benefits of lending securities into these markets.

With a lending program founded on a combination of local market expertise and global experience, a customized structure—created precisely to satisfy specific risk, collateral and liquidity requirements—can provide asset managers with the dual investment advantages of preserving principal and optimizing yield.

**Long History of Growth**

Since the first cross-border securities lending transaction in the 1970s, international activity has grown rapidly. Contributing factors include the overseas expansion of the U.S. broker dealers and custodian banks, the growth of the international derivatives markets, the establishment of significant numbers of hedge funds, the introduction of book entry settlement systems (and the resulting greater processing volumes), technological advances (e.g., computer processing power, access to real-time price information, automated trade execution) and the removal of many regulatory, tax and structural barriers to securities lending in local markets throughout the world.

Paralleling this remarkable growth of securities lending activity has been the dollar volume of lendable assets. The Risk Management Association reports that during the first quarter of 1999 (the first period tracked), lendable assets totaled $2,287,743 million. In 1Q06, the comparable figure was more than two and a half times greater: $6,265,716 million.

Today, because the existing markets that provide securities lending are becoming commoditized, with resultantly narrowing spreads, emerging/developing markets can offer a dedicated supply of securities to add incremental returns to a fund’s results. At the same time, by providing these activities, these countries are bolstering their stature as significant participants in the global capital markets.

**Considerations for Securities Lending into Emerging/Developing Markets**

For institutional investors worldwide, securities lending can be an integral part of maximizing the performance and profitability of their investment activities. The activity enables them to earn incremental income on their portfolios while simultaneously managing the program to mitigate risk. When reviewing investment opportunities to enhance portfolio returns, asset managers considering lending securities into emerging/developing countries should take into account the following local market policies and procedures:

- **Regulatory approval**
  The mandatory prerequisite for securities lending is regulatory approval allowing short selling. This process can occur in stages, with, for example, initial authorization for domestic investors, followed by expansion to investors worldwide. When the regulatory authorities in Korea first approved regulations for short selling and securities lending, they did not permit offshore institutions to participate. Working independently and through the influential Pan-Asia Securities Lending Association (PASLA), the regulators were educated about the benefits of a more comprehensive securities lending program and subsequent regulatory changes to allow offshore investors made Korea a more liquid and attractive market in the global economy.
Similarly, when regulators in Taiwan first approved short selling and securities lending two years ago, they created a structure that initially limited activities to local borrowers and lenders, with collateral held onshore in Taiwanese dollars—restrictions that seriously impeded offshore participants to lend securities in Taiwan. Again, following discussions with PASLA and other market participants, the regulatory authorities agreed to open Taiwan securities to offshore lenders. The revised lending parameters opened up a new market for lenders to earn revenue and benefited the Taiwanese marketplace by injecting a new source of liquidity.

Tax review
As part of their securities lending program, emerging/developing markets also need to review legislation to remove tax-related issues that would preclude investment interest. In Mexico, a number of leading agents declined to enter the market because, in their interpretation, the tax laws would have imposed capital gains taxes on their customers’ lending transactions. However, time and local resources were devoted to inform the tax regulators about the ramifications of the legislation on the local market and the benefits the local market would accrue from changing the laws.

Risk Assessment
Assessing risk in emerging/developing markets requires singular capabilities and meticulous evaluation techniques. For securities lending specifically, institutional investors are rightly concerned about borrower default, collateral reinvestment, operational and legal/contractual risk.

Complementary Capabilities—Partnering to Ensure Success
“Performance” is the mantra across the investment management industry, and the securities finance component is no different. With continuing demand from clients to attain ever-improved results, investment firms are increasingly having to focus on their core competencies—business development, portfolio management, client service—and are establishing strategic relationships with partners with complementary capabilities that deliver performance and bring market-proven expertise to the value chain. For asset managers, critical to ensuring their success in maximizing the returns of their portfolios when lending in emerging/developing markets is forming an alliance with an experienced partner that demonstrates the following credentials:

- Local Market Intelligence and Global Experience
  Institutional investors have traditionally been reluctant to lend securities in emerging/developing markets because of its perceived complexity. An alliance partner should therefore demonstrate credentials of having successfully established programs in emerging economies around the world, of having worked as a financial partner with local regulators and policymakers to simplify and streamline the process. As an active participant in local industry, the partner should be able to transfer “lessons learned” and “best practices” from other markets to educate local regulatory authorities about the benefits of securities lending, thereby making these markets increasingly attractive to investors seeking to lend securities.

- Owning the Trade—from A to Z
  The model alliance partner should “own the trade, from A to Z” by being deeply embedded within the securities lending market and exceptionally experienced in the details of the process. By demonstrating extensive expertise across all functional areas in the space—custody, clearing, settlement, prime brokerage, risk management, domestic and international trading, collateral management, processing corporate action entitlements, collecting dividends and so on—the partner can create a customized securities lending structure that precisely satisfies a fund manager’s risk requirements while delivering superior execution and maximizing portfolio performance.

- Integrated Operations and Communications Network
  The partner should also maintain an integrated operations and communications network that seamlessly connects its securities lending desks in major capital markets around the world. This technological capability—which allows for direct, 24-hour access to local market intelligence that can then be immediately disseminated across the network—greatly facilitates the securities lending process and enables the partner to deliver consistent performance worldwide.

By lending securities into emerging/developing markets, asset managers worldwide can:

- Maximize the value of their portfolios
- Increase demand for their portfolios
- Rely on on-the-ground presence and local expertise in these markets to provide them with news about the latest regulatory, tax and market changes.

For additional information about securities lending at Citigroup, which currently lends into 30 markets, contact Tim Douglas, Global Head of Securities Finance, timothy.s.douglas @citigroup.com.