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## Welcome

The summer season is now in full swing which traditionally signals the falling off in equity volumes after the peak months of March, April, and May. The graphs at the end of the newsletter chart the total balances by fixed income and equity and, more interestingly for lenders, the peaks in 'return to lendable' that we have seen this year, which have been more dramatic than in previous years. This has been driven mostly by the fixed income markets and the start of the European equity season. For the first half of the year it was fixed income markets that provided lenders with incremental opportunities as the equity markets, more or less, fell into line with previous years.

For the remainder of the year, one of our main projects is the transition of the OSLA 95 to the GMSLA 2008. This will impact all of our borrowers and lenders and there is more detail at the end of this newsletter. Moreover, we will be in touch with you regarding these changes and their impact.

[Click here to view charts.](#)

## US equities

### Balances

Overall average balances were down 4.84 per cent for the month.

### News<sup>1</sup>

Early in the month the Dow took a big hit, wiping out all of the previous month's gains as higher oil prices dampened investor's recent optimism. A weak job market and skyrocketing oil prices kept downward pressure on the Dow for most of the month. The Labor Department reported that the unemployment rate jumped half a percentage point to 5.5 per cent in May, its highest level since October 2004 and

its sharpest one-month increase in 22 years. On Friday 27 June, stocks slid into bear-market territory as credit-related fears remained rampant and crude prices climbed to new records putting pressure on the market one day after blue chips plummeted to lows not seen in nearly two years. The Dow is down over 20 per cent from its intraday high set in October – a decline of 20 per cent from a high is traditionally considered the threshold for a bear market. Analysts continue to reduce expectations. The Dow had its worst month since 2002 and its worst June since 1930.

### Active stocks

- Allied Capital **ALD**
- Braskem **BAK**
- Chipotle **CMG**
- Fortress **FIG**
- Luminent **LUM**

Sectors in demand included: autos, subprime lenders and exchange-traded funds (ETFs). Some drivers of this demand included: asset valuations, downgrades, commodity prices and supply issues.

<sup>1</sup> Bloomberg/WSJ, accessed on 06/02, 06/06, 06/12, 06/20, 06/27, 06/30, 2008.

## US corporate bonds

Overall average balances were down 2.24 per cent for the month.

### News<sup>1</sup>

BE Aerospace Inc., the world's largest maker of aircraft-cabin interiors, plans to sell USD500 million of debt. Banco Pina, the Sao Paulo-based bank that went public last year, sold USD150 million of two-year bonds. Standard & Poor's (S&P) assigned the 7.375 per cent notes a BB- rating, three levels below investment grade, according

to data compiled by Bloomberg. Corporate bond sales so far this year total USD595 billion, compared with USD675 billion in the same period in 2007. Underwriting volume was the weakest in the types of bonds that have inflicted some of the worst losses on Wall Street. In the second quarter, global mortgage-backed securities volume fell 87 per cent from the second quarter of 2007; asset-backed debt fell 79 per cent; and risky, high-yield bonds that financed private-equity buyouts fell 67 per cent.

### Issues in demand

- NTK Holdings (CUSIP 62941EAB7)
- Dollar General (CUSIP 256669AF9)
- Visteon (CUSIP 92839UAD9)
- GM Corp (CUSIP 370442BS3)
- S Freightways (CUSIP 916906AB6)

<sup>1</sup> Bloomberg/WSJ, accessed on 06/13, 06/27, 06/30, 07/01, 2008

## US Treasury and agency

The US Treasury spreads versus both agency and mortgage collateral remained narrow throughout June. However, the demand for zero-risk-weighted treasuries over quarter-end (June 30) pushed the Treasury/Fed Funds spread to over 60 basis points (bp) overnight. Conversely, agencies for quarter-end saw decreased demand and traded over Fed Funds by 15 basis points. Despite the heightened demand for treasury collateral over quarter-end, collateral placement for “the turn” proved to be quite challenging due to the increased focus on balance sheet by the dealer community. Nearly all primary dealers scaled down their cash trades with

non-netting securities lenders. The dealers that were not constrained by their balance sheet seized the opportunity and took collateral on their books at an increased premium. The spreads between treasury, agency and mortgage overnight financing will most likely return to within 2 to 3 bp after the turn and into July as the Federal Reserve’s liquidity facilities continued to flood the street with collateral.

The current Treasury issues were not in strong demand this month. The only current Treasury to average more than 75 bp was the 10-year. The 2-year averaged just 22 bp and the 5-year only 20 bp.

The FOMC left the Fed Funds rate unchanged during their 24/25 June meeting. The futures had been pricing in just a 10 per cent chance of a 25 bp tightening for the days prior to the meeting. The announcement on 25 June stated the FOMC’s concerns over inflationary pressures and that they would be ready to combat inflation pending future market data. As of this writing (2 July), the futures market is pricing in a 46 per cent chance of a 25-bp tightening and 54 per cent of no change during the 5 August FOMC meeting.

## Fixed-income and money markets

June began with yet another weak US employment situation report that indicated the unemployment rate surged from 5.0 to 5.5 per cent in the month of May, while non-farm payroll was shown to have decreased by 49,000 jobs. While it remained unlikely that the FOMC would consider any further rate-cut at its meeting later in the month, this kind of data would clearly make it extremely difficult for it to consider raising interest rates anytime soon. The FRB continued to issue statements to the effect that there was an elevated concern about inflationary pressures resulting from higher energy

and commodity costs, and the market continued to price in one or more rate hikes before year-end.

Of equal concern and importance during June was the balance-sheet constraint being exhibited by the broker-dealer community. Whereas in the past several years it had been virtually assured that there would be a strong demand at calendar quarter-ends for US Treasury securities from the securities-lending industry, it was becoming apparent throughout the month that such demand would be superseded by the borrowers’ requirements to restrain taking on

additional liabilities and increasing the size of their balance sheets. In response to this change in market dynamics, our fixed-income trading and cash-collateral management desks began to structure an increasing amount of liquidity into the portfolios for month-end. By mid-month, it became apparent that there was virtually no appetite for term loans matched with term investments, and business had to be turned away. Liquidity remained scarce in the interbank market for quarter-end, and we saw overnight euro deposit rates reach as high as 3.50 per cent despite the 2.00 per cent Federal Funds target rate.

## European equities

### Balances

Overall balances have decreased by 15 per cent for the month. This is due to market conditions and term trades running to duration.

### News

Intra-day trading exempt from FSA rules (ISF June 19)

Hedge funds and other investors that keep short-selling positions less than a day would be exempt from the UK’s new disclosure requirements, which took effect on 20 June, Bloomberg reports.

The clarifications also revealed that short-sellers who went above the 0.25 per cent

trigger-point several times in a day would only have to disclose their trades once.

The FSA paper confirmed: “If a person assumed a short position of 0.25 per cent or above on a day, but had unwound that position by 23.59 on the same day, they would not be required to make a disclosure.”

The new rules, designed to protect banks offering rights issues, may also restrict hedge funds from borrowing stock between the announcement and completion of a rights offer.

According to the FSA, options must be included when calculating short positions, including options that can’t be exercised during the rights offer period. The FSA is

continuing its general review into rights offers with the Treasury, and is considering whether the process could be sped up by bypassing a shareholder vote. The time between an announcement of rights offer and its completion can currently be as long as 12 weeks.

European stocks fall for fourth week<sup>1</sup>

European stocks completed the fourth weekly decline on mounting concern that record oil prices, higher borrowing costs and slowing economic growth would erode earnings. Daimler AG, the world’s second-largest maker of luxury cars, and Ryanair Holdings Plc paced a retreat in companies

sensitive to fuel costs as crude rose above USD142 for the first time. Carrefour SA, Europe's biggest retailer, led retail stocks lower after scaling back forecasts for operating profit and sales. Europe's Dow Jones STOXX 600 Index tumbled to 287.34. The measure is poised for the worst first half since at least 1987 as record oil prices, inflation and credit-market losses approaching USD400 billion weighed on shares.

#### Active stocks

Relative value and M&A news<sup>2</sup>

- TomTom (TOM2 NA)
- Hagemeyer (HGM NA)
- Banca Popolare (BPM IM)
- Sacyr Vallehermoso (SYV SM)
- Sabadell (SAB SM)
- Tui (TUI1 GY)

Directional and convertible-bond news

- Brad & Bingley (BB LN)
- Alliance & Leicester (AL/LN)

- Bovis Homes (BVS LN)
- Persimmon (PSN LN)
- Taylor Wimpey (TW/LN)
- Tiscali (TIS IM)
- Bca Mps (BMPS IM)
- Air Berlin (ABI GY)
- TeleAtlas (TA NA)
- Gestevisión (TL5 SM)

Sectors and markets in demand: bank and housing.

<sup>1</sup> Bloomberg, accessed on June 29  
<sup>2</sup> CGML Equity Finance Desk

## Legal update

In July 2007, the International Securities Lending Association (ISLA) published a consultation paper on changes made to the most recent market-standard lending document in Europe, the GMSLA 2000. ISLA, which has consulted with the various industry product groups since looking at possible changes since 2005, approached the revised GMSLA with the following principals in mind:

- The document should, where possible, incorporate the common requirements of both lenders and borrowers.
- The final document should be flexible and allow for individual requirements to be incorporated, application in various jurisdictions and adaptability where appropriate to changes in law (e.g. tax).
- As far as possible, the document should be drafted in a manner that is easy to interpret and understand, using clear

- and generic terminology, for non-lawyers. Navigation should be improved and the font size made easier to read.
- The final document should be in a form that demonstrates to the market that the business is capable of self-regulation.
- As far as appropriate, the GMSLA should use the same language and form as the Global Master Repo Agreement (GMRA).
- The GMSLA should reflect the life cycle of a trade.
- The GMSLA should identify all likely events that might have a tax consequence and identify the party that would bear the associated tax risk.
- The GMSLA should be a manageable length, and consequently should not cover every possible eventuality. Points of detail should be addressed in a limited number of addenda (e.g. tax).

After subsequent discussion with legal and tax groups, ISLA prepared a new version of the GMSLA and invited market participants to comment. Citi provided its comments in its capacity as securities-lending agent in early July 2008.

It is expected that the GMSLA and relevant annexes will be completed by the end of 2008. Once it has had a chance to fully digest the changes to that agreement, Citi plans to move from the OSLA 95 upon which all lenders and borrowers are signed to the GMSLA 2008, and will organise a working group to sign up lenders and borrowers to that agreement. The GMSLA has the benefit of being used for all types of lendable securities, unlike the OSLA, which is only used for overseas securities loans, with the GESLA and MEFISLA being used for gilt loans and UK fixed-income loans, respectively.

For further information, please contact your Citi representative.

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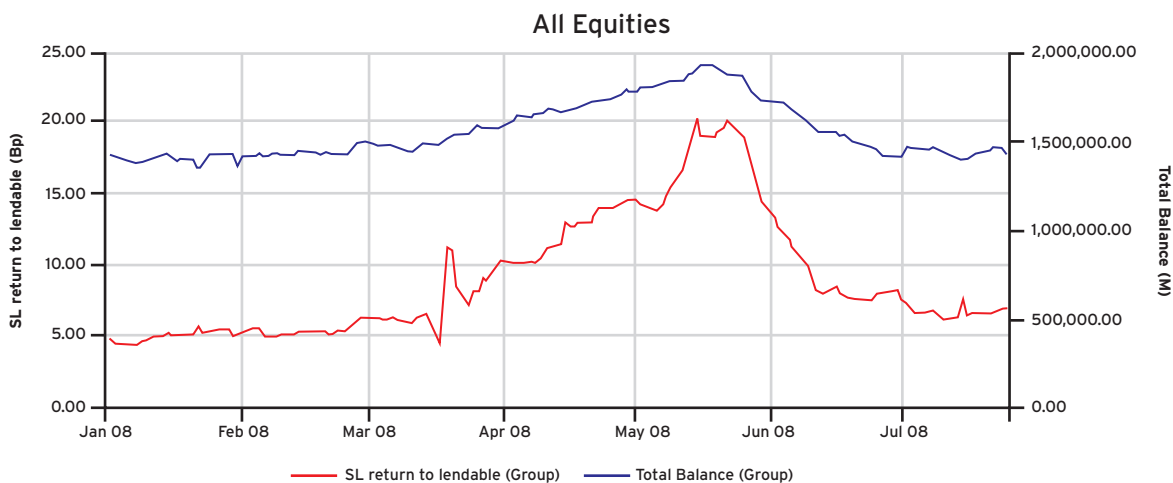
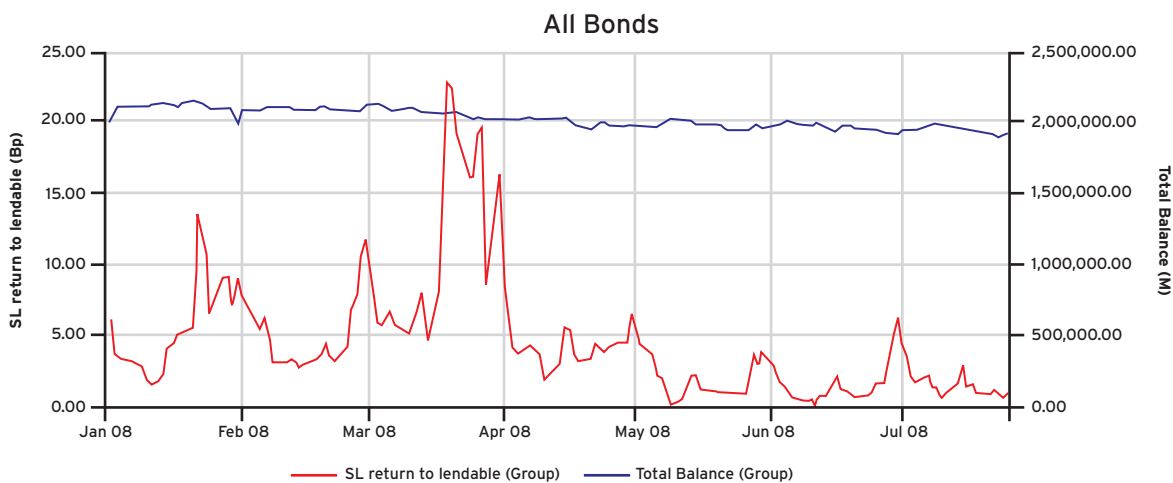
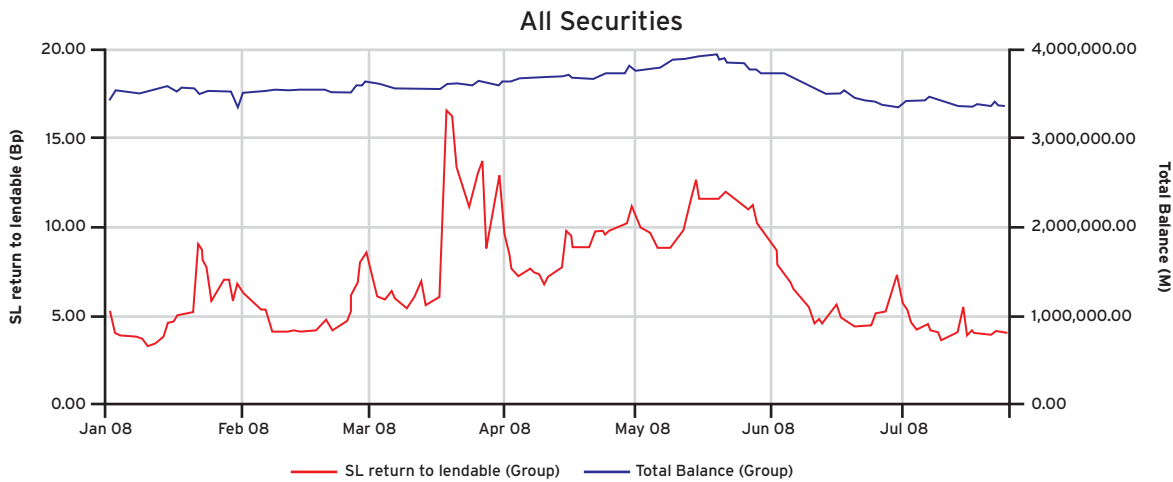


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