



## Welcome

August is typically a month in the securities finance calendar where the summer vacations are in full swing and the financial markets beginning to slow from the peak of early summer. From August into September this year, we have seen breaking news about the purchase of Merrill Lynch, a huge transaction, and now we have the insolvency filings for a number of Lehman Brothers entities in Europe and now in the US. This level of market volatility is unprecedented. When this type of event happens within the securities finance industry it fully tests the events of default procedures. The mark to market process is absolutely invaluable in re-pricing loan and collateral securities and the ability to seize collateral, sell it and buy back equivalent securities in a timely manner, is critical to this whole process.

**Brian Staunton**  
Managing Director,  
Securities Finance,  
EMEA, Citi

In addition to all this a number of regulators, notably the FSA and the SEC, have announced temporary measures to restrict short selling in a number of financial securities whilst the financial community go through this volatile period. The FSA rule prohibits the active creation or increase of short positions in 29 listed UK financial sector companies until January 2009 and the SEC rule restricts short selling in 799 listed financial institutions for 10

business days to 2 October. Explicitly, these rules do not prohibit securities lending per se - attached to this newsletter is the FSA announcement. Rest assured Citi, as your lending agent, is implementing all required procedures or protocols in order to be compliant with the request.

Finally, I want to draw your attention to an increasingly popular type of corporate action referred to as a "Rapid". Attached is a Q&A that I hope you will find useful, but if you have any questions on this or any other aspect of this market monitor please do not hesitate to contact either of the people listed at the end of this document.

## Euro Money Markets

Economic data released during the month has shown that even the euro zone's strongest member countries are not immune to the credit crunch. German manufacturing and service industries contracted in August and consumer confidence remained at a five year low. With oil prices, which boosted inflation globally, falling over 20 percent during the

month and fears that the euro zone may enter into recession, the markets are now betting that the European Central Bank may reverse July's 25 basis point (bp) hike in early 2009.

As the usual August holiday lull in the markets drew to a close, three month Euro libor continued to hold near the highest

levels seen since December 2000. Bank commercial paper spreads to general collateral remain attractive in the two and three month period, but we are finding better investment opportunities in term repo for one month investments.

## Domestic Equities

### Balances

Overall average balances were up 1% for the month.

### News

Early in the month stocks surged amid a continuing plunge in oil prices as investors bet that lower energy costs could relieve some pressure on companies and consumers in this deteriorating economic environment. However, bleak earnings news in the financial sector and growing signs of consumer distress prompted a broad sell-off soon thereafter. Fears of a global economic slowdown continued

to push prices lower across the board on raw-materials, leaving U.S. stocks in limbo. Later in the month, share prices of Fannie Mae and Freddie Mac plunged amid growing fears that the two largest providers of funding for U.S. home mortgages will not be able to avoid a government bailout. In recent trading, the Dow was up modestly, hovering around the 11,500 mark.<sup>1</sup>

### Active Stocks

- **Allied Capital ALD**
- **Braskem BAK**
- **Boyd Gaming BYD**

- **Chipotle CMG**
- **Dillards DDS**

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

<sup>1</sup> Bloomberg/WSJ 08/05, 08/07, 08/11, 08/22, 2008

## Domestic Corporates

### Balances

Overall average balances were up 4.25% for the month.

### Current News

Towards the end of the month, U.S. corporate bond sales slowed to the lowest level in months as the extra yield sought by investors led to a shift to investment-grade bonds from government debt. Borrowers raised U.S. \$2.82 billion the week ending 22 August, compared with U.S. \$16 billion the previous week and U.S. \$28 billion at the same time last year. Sales dropped amid concern that Fannie Mae and Freddie Mac, the two largest U.S. mortgage-finance

companies, may need a government bailout, causing banks to rein in lending and boosting costs for corporate borrowers. The average spread on investment-grade debt rose to 312 bps, surpassing the record set when the Federal Reserve (Fed) backed a rescue of Bear Stearns by JP Morgan Chase in March this year Treasury Secretary. Henry Paulson (last month) was also granted authority to take equity stakes in Fannie Mae and Freddie Mac and extend them more credit should their financial conditions deteriorate and their ability to raise capital falter. Freddie Mac paid the highest yields over Treasuries on record in a debt sale on August 19 amid

concern that credit losses are depleting the company's capital. In other news, AIG of New York, the biggest U.S. insurer, sold U.S. \$3.25 billion of 10-year notes at more than double the spread offered on similar debt in December<sup>1</sup>.

### Issues in Demand

- **El Pollo (cusip 28383LAE5)**
- **Charter (cusip 161175AG9)**
- **Realogy (cusip 75605EAT7)**
- **Station Casinos (cusip 857689AV5)**
- **Visteon (cusip 92839UAB3)**

<sup>1</sup> Bloomberg/WSJ 08/15, 08/22, 2008

## Ratings

The global credit turmoil and its subsequent ratings effects have continued to cause global bank rating and corporate downgrades throughout the summer of 2008. Some of the downgrades include: Fortis Bank SA/NV, which was downgraded to A+ from AA- by S&P<sup>1</sup>. American Express Company and its affiliates were placed on review for downgrade by Moody's<sup>2</sup>. Morgan Stanley also experienced a downgrade to

its long-term ratings as Moody's lowered its long-term rating from Aa3 to A1<sup>3</sup>.

In other events, the long standing potential sale of Dresdner Bank AG (a wholly owned subsidiary of Allianz AG), was tentatively announced in the latter half of August 2008. Commerzbank AG will acquire Dresdner and plans to complete the transaction by year end. Although the transaction is just

announced and not completed, Moody's downgraded the long-term rating of Dresdner to Aa3 from Aa2<sup>4</sup>. Commerzbank ratings were not affected as of 31 August, however, on 2 September, Fitch placed the long term ratings on negative watch<sup>5</sup>.

<sup>1</sup> www.ratingsdirect.com accessed 8-6-08

<sup>2</sup> www.moodys.com accessed 8-7-08

<sup>3</sup> www.moodys.com accessed 8-11-08

<sup>4</sup> www.moodys.com accessed 8-28-08

<sup>5</sup> www.fitchratings.com accessed 9-2-08

## U.S. Fixed Income and Money Markets

The month began with a report indicating that the U.S. economy had lost yet another 51,000 jobs and that the unemployment rate had unexpectedly increased to 5.7 percent from 5.5 percent. There was rhetoric that inflationary pressures were mounting to such an extent that the Federal Open Market Committee (FOMC) might need to tighten short-term interest rates, but such a move seems unlikely in the face of the present employment situation and other economic data. It therefore came as no big surprise to the market when on, 5 August, the FOMC decided to leave the Federal Funds target rate unchanged at 2 percent. In its statement following the meeting, the Committee stated that, "Although downside risks to growth remain, the upside risks to inflation are also of significant concern to the Committee."<sup>1</sup> The market picked up on the fact that the

previous statement had mentioned that the downside risks had "diminished", and that the tweaking of the language was meant to maintain stability in the market. According to former Fed governor Lyle Gramley, "They want to remind people that their concern for inflation is genuine, but they have no intention of doing anything about it right away."<sup>2</sup>

August also marks the one year anniversary of the beginning of the liquidity crunch that has, and continues to, significantly impact the market and its behavior. Risk aversion continues to dominate the behaviour of stable value investors, although money market funds have seen almost U.S. \$1 trillion of in-flows, they remain extremely selective about where they invest and maintain liquidity well above historical averages. Investors, such as enhanced

cash funds, which had been willing to trade liquidity for additional yield, have all but disappeared from the market completely. For banks engaged in securities lending, longer term investing has been curtailed in favour of maintaining liquidity. As a result, and despite the efforts of the U.S. and European Central Bank, Libor spreads remain historically high. European banks will be facing the need to roll over a large amount of floating-rate notes that become due over the next month or so placing even more pressure on those spreads. In summary, it can easily be assumed that the market will continue to be reshaped over the months, if not years ahead.

<sup>1</sup> FRB NY website, 5 August 2008

<sup>2</sup> "Fed Shift Indicates Main Rate will Stay at 2% to Revive Economy" by Scott Lanman-Bloomberg 6 August 2008

## U.S. Treasury and Agency

Compared to July U.S. Treasuries and Agencies experienced spreads which were slightly compressed during August. While the market remained flush with treasury and agency paper, the spread between Treasury GC and Fed Funds Open averaged just four bps throughout the month. Moreover, the spread between Treasury GC and Agency GC was just one bp. It is likely that narrow spreads similar to these may exist throughout the remainder of the year, and through January. The Federal Reserve announced that both the Term Securities Lending and Primary Dealer Credit Facilities have been extended to 30 January 2009. The Fed's statement indicated that "unusual and exigent"

circumstances still exist in some financial markets. The Fed's statement read, "In light of continued fragile circumstances in financial markets, the Board has extended the PDCF through January 30, 2009, and the Board and the Federal Open Market Committee have extended the TSLF through that same date." The announcement also read, "These facilities would be withdrawn should the Board determine that conditions in financial markets are no longer unusual and exigent."

The current U.S. treasury issues traded moderately special throughout August. The current 2-year and 10-year note traded

with approximately 45 bps of intrinsic value and the current 5-year averaged 60 bps.

During the 5 August FOMC meeting, the Fed opted to keep the Fed Funds rate in place at 2 percent. Despite the 2 percent funds target, the Fed Funds Open Index averaged 2.09 throughout August. The futures market is currently (5 September) not pricing in any significant change in the Fed Funds rate until year-end.

---

## Australia: Renounceable Accelerated Pro-rata Issue with Dual-Bookbuilds (RAPIDS)<sup>1</sup>

Further to our Market Watch (AUSTMW05508) on 6 August 2008, Citi would like to advise clients of the action that is required in relation to primarily 'institutional' offers made by lead managers relative to RAPIDS.

RAPIDS are an innovative structure to enable large amounts of equity to be raised quickly. The timeframe for an institution to determine whether to accept the offer is extremely short and is generally closed one business day after it was announced. Details of how to accept the offer will be contained within the offering provided by the lead manager.

Citi would therefore like to outline the necessary deadline for clients who are part of our Citi's agency lending program. This will ensure the required steps are taken by our lending teams with the respective borrowing parties.

As Citi will be unaware of any approach from the lead manager, the onus is on our

clients to instruct our Corporate Action (CA) Lending team if they have been invited to participate in any Australian Institutional Offers (RAPIDS) immediately as instructions will be required for both a take up (subscribe) or lapse instruction.

Clients must submit valid instructions to Citi's CA Lending team no later than 17:00 GMT on the official announcement date of a RAPID event. Given that these are unsolicited instructions, all client instructions must be preceded by a telephone alert to any of the following numbers:

- +44 20 7500 9116 (Dean Zhang)
- +44 20 7508 6422 (Claudia Radoslovich)
- +44 20 7508 2896 (Stuart Collins)

All instructions received outside of the above guidelines will be dealt with on a reasonable endeavours basis, with all liabilities rested with the client.

Citi's CA Lending team will subsequently advise the borrower of the lenders institutional election and agree additional loan positions or lapsed payments depending on lender election with the borrowers, and facilitate payment of the necessary subscription costs. Upon payment the newly received shares will be collateralised accordingly. If it is a lapse/take-no-action instruction, Citi will process any proceeds pertaining to this upon receipt from the borrower.

Please note, any 'retail' offers made by participating companies will be announced and notified by Citi upon receipt of information from our local sub-custodian and deadlines will be set in accordance.

Clients seeking further information on this change should contact their Global Transaction Services relationship manager.

<sup>1</sup> Citi Australia

# Frequently Asked Questions

## **Question: What is a RAPID issue?**

Similar to a traditional renounceable rights offer, a RAPID issue is an entitlement offer where each registered shareholder of the company at record date will receive an entitlement, which they can either take up or renounce (in full or in part).

## **Question: How does a RAPID differ from a traditional rights issue?**

Although similar to a rights issue a RAPID has five unique features:

**1. Two-tranche shareholder offering** - The event is effectively held in two tranches and is broken up into an institutional and retail component:

- **Institutional** - The first tranche is by invitation only to institutional shareholders and covers a large portion of the shares being issued.
- **Retail** - The second tranche is the retail offering which is open to all shareholders who were not invited to participate in the institutional offering i.e. first tranche. This offer is typically made to those
- investors with smaller holdings.

**2. Method of communicating the offer** -

Under a RAPID offer the lead manager works with the issuer to identify large institutional holders. The lead manager(s) will approach eligible institutional shareholders directly (i.e. not via a custodian). These shareholders must decide whether or not to take up their entitlement and confirm this back to the lead manager(s). Custodians are not involved in the communication of the institutional offer, the determination of whether an institutional client can participate (due to jurisdictional restrictions) or the collation of the instruction. This process is undertaken by the lead manager and details of who the offer is made to is privy to the lead manager and the institutions to whom the offer has been made to; effectively by-passing the custodian.

Citi will announce details of the retail offer once this is released to the market in the normal manner as is done for a rights issue.

**3. Short time frame for election** - The timeframe for an institution to determine whether to accept the offer is extremely

short. The institutional offer is generally closed one business day after being announced. Details of how to accept the offer will be contained within the offering provided by the lead manager.

**4. Bookbuild processes for renouncing rights** - Unlike a renounceable rights issue where rights can be sold on the market, under a RAPID issue, lapsed rights (as a result of a shareholder deciding not to accept the offer or being ineligible) are sold as part of a bookbuild process. There are two separate bookbuild processes, the first being the sale of all entitlements not taken up under the institutional offering. The second bookbuild process is to sell all entitlements not taken up in the retail component of the offer. The lead manager(s) will generally be responsible for coordinating the bookbuild processes, which is effectively an auctioning of shares not taken up.

**5. Multiple dispatch dates for entitlements** - Allocation of entitlement shares received under the institutional offering will be dispatched earlier than entitlements allocated under the retail offer. This is due to the fact that institutions accepting the institutional entitlement offer will pay application money to subscribe earlier than those accepting under the retail offer.

## **Question: Are all Institutional shareholders guaranteed to receive an offer under the institutional offer?**

No, the lead manager(s) will ultimately determine whom the institutional offer is being made to.

## **Question: How can I find out if someone within my organisation has been made an offer under the institutional offer?**

The lead manager(s) can confirm whether someone within your organisation has been made an offer and who this person is. These offers will generally be communicated to institution/trading desks so we also recommend that you liaise with these teams within your organisation.

## **Question: If I was made an institutional offer and did not take it up, can I decide to accept the retail offer at a later date?**

No, if you were made an offer under the institutional offer you cannot then

participate in any form under the retail offer.

## **Question: If I do not take up the rights will I receive the same amount of renunciation proceeds regardless of whether I was made an offer under the institution or retail offer and how will this price be calculated?**

No, the amount you receive as a result of having your entitlement sold will be dependant on the price determined by the bookbuild process. This price may differ between the two bookbuild processes. The first bookbuild will involve the sale all renounced entitlements from the institutional entitlement offer i.e. those institutional shareholders that were either ineligible or decided not to take up their rights. The second bookbuild will involve the sale all renounced entitlements from the retail entitlement offer. The second bookbuild for retail entitlements will generally take place approximately one month after the first institutional bookbuild, thus price may differ.

If the final price from either bookbuild process exceeds the application price, then the excess amount is returned to those shareholders that have renounced their entitlement i.e. the difference between the bookbuild price and the application money is deemed to be the renunciation proceeds.

## **Question: If I have accepted the institutional offer do I need to advise my custodian?**

Yes, entitlements accepted under the institutional offer will settle via the CHESS DVP process, in a similar way to a market trade, so you will need to instruct Citi via an MT541 SWIFT message. The lead manager will provide accepting shareholders with the applicable settlement details. Care should be exercised when instructing Citi as the institutional entitlement securities settlement codes are usually distinguishable by the letters 'XX' after the standard three letter ASX code.

## **Question: How do the terms differ between the institutional and retail entitlement offer?**

The entitlement ratio, record date and application money are the same. The key

difference between the two offers is that under the institutional offer application money is paid earlier and entitlements are allocated earlier.

**Question: Are there any restrictions in receiving shares under a RAPID issue due to jurisdiction of an underlying client?**

The same restrictions apply as they do for a standard rights issue i.e. the company will determine any jurisdictional restrictions that apply in taking up shares. We will advise any restrictions under the retail entitlement offer in the normal manner i.e. as part of our announcement of the retail offer.

**Question: What are the obligations of stock-borrowers and lenders under a RAPID issue?**

Generally, lenders entitlements should be protected but ultimately this will depend on the arrangements that are in place between the borrower and lender. Given the short time frame for instructing on

the institutional component of a RAPID issue each of the following parties should act promptly to ensure that the beneficial owner's interests are protected.

- **Beneficial owners/investment managers** - If you are part of a lending program upon receipt of an invitation to participate in the institutional tranche of a RAPID you should contact your custodian to ascertain whether stock has been lent out. Where it has been lent out you should immediately instruct the custodian on your election decision.
- **Direct lender** - Where you are lending on behalf of a client (as agent) contact your client to confirm whether they have received an invitation to participate in the institutional offer. Contact all borrowers impacted to ascertain whether any of the stock will be returned by the record date. In situations where stock will not be returned by the record date, you should agree on a deadline

with your borrowers to confirm whether protection is required in the institutional offer.

- **Borrower** - Contact your lender to confirm whether the lender has received an invitation to participate in the institutional offer. Agree a deadline with the lender for any protection requirements.

**This is in-line with the recommendation of the Australian Securities Lending Association who have issued a paper on RAPIDs including best practices for the lending and borrowing community. This paper can be located at <http://www.asla.com.au/info/ASLARapids26Feb08.pdf>**

**If you have any more questions please contact your Securities Finance relationship manager directly.**

For further information, please contact your Citi representative.

## Contacts



**USA, New York**

**Laurie Zeppieri**

**Tel: +1 212 657 1075**

**Email: [laurie.zeppieri@citi.com](mailto:laurie.zeppieri@citi.com)**



**Europe, London**

**Brian Staunton**

**Tel: +44 (0) 20 7500 5411**

**Email: [brian.staunton@citi.com](mailto:brian.staunton@citi.com)**



**Asia, Hong Kong**

**Larry Komo**

**Tel: +65 6328 5377**

**Email: [lawrence.komo@citi.com](mailto:lawrence.komo@citi.com)**

**Global Transaction Services**  
**[www.transactionservices.citi.com](http://www.transactionservices.citi.com)**

To view the full range of Citi's Securities and Fund Services' industry-leading global information, visit Market Guide, our market and service intelligence channel at <http://securities.citidirect.com>. For site access or additional information, please contact your Global Transaction Services representative.

This document is solely for information and we will not be responsible for updating any information contained herein. It is not intended to provide specific advice on any other matter. If advice is required, legal, tax or otherwise, you should consult your own advisers, legal or otherwise. No responsibility for any loss occasioned as a result of using this document is accepted. Under no circumstances is it to be considered an offer to sell or a solicitation to buy any investment or product.

© 2008 Citibank, N.A. All rights reserved. Citi and Citi and Arc Design is a trademark and service mark of Citigroup Inc., used and registered throughout the world.

GRA19729 09/08