

PASLA market profile: Australia

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Australia was one of the last markets to lift the ban on short selling but has gained a reputation as a market that deserves attention

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Australia has the most mature economy in the Asia Pacific region and was able to weather the global financial crisis better than many other developed markets. However, like most countries around the globe, it was not completely unaffected.

The credit crisis which began in September 2008 had a profound impact on the securities lending industry there with extensive short selling bans, regulatory changes and a large amount of negative press coverage.

Indeed, the Australian market was the last major global jurisdiction to lift its ban on short selling back in May last year in the face of vociferous calls from the industry to do so.

Activity in the region declined over the past 18 months – as it did in many markets – but it looks as though the country is in the midst of a recovery.

The market failed to hit the lows that many others did partly because of its close links to the Asian region and the huge demand for Australian produce. This is also a reason why it is rebounding well. Many people within Australia now see their fortunes more closely linked to the region than to the US.

The Australian compulsory superannuation scheme is another important driver for growth on the supply side of securities lending. It was introduced in 1992 and began as a 3% compulsory superannuation contribution by the employer of any worker in Australia. Over the years it has grown to 9% where it currently stands today. Most Australians actually match the 9% their employers must pay.

These massive funds mean there is a lot of capital to be invested and securities lending gets a slice of that.

J.P. Morgan recently bought the custodian services business of Australia and New Zealand Banking Group (ANZ) with the deal closing at the end of last year. The move gives J.P. Morgan access to over 100 clients and \$90.848 billion in assets under custody. Northern Trust and eSecLending are other reasonably recent entrants into the market.

“There is certainly more stability in the Australian market today,” Giselle Awad, senior vice-president at eSecLending Asia Pacific told Global Investor/ISF.

“Throughout 2009, many beneficial owners allocated a significant amount of time reflecting on the lessons learned from the credit crisis. They have been looking at ways to structure their programmes going forward including the review of alternative providers and routes to market in recognition of the industry’s changing landscape. As they review their programmes, many are looking for greater transparency, control and customised solutions built around their unique risk/return parameters and goals. They are increasingly viewing securities lending as an investment management and trading product rather than an operational service tied to custody. While the financial crisis had a profound impact on the securities lending market, we believe that the evolution of the industry that has and will continue to occur as a result, is positive.”

The pension market and superannuation market in Australia is the fourth largest in the world which is one of the reasons why Australia is such a draw. Since 2000 the Australian hedge fund industry has grown four times faster than the rest of the hedge fund world driven largely by massive liquidity growth in pension funds.

Francesco Squillacioti, senior managing director and regional director, Asia-Pacific, Securities Finance at State Street told Global Investor/isf: "Superannuation funds represent a very large and growing pool of assets, and one that has historically engaged in securities lending so it is certainly of interest to us.

"In general, we believe that securities lending in Australia has offered institutional investors the opportunity to realise incremental returns and other tangible benefits. We see that trend continuing as the market expands."

One area that has hindered the Australian market is the general mistrust of shorts selling. Its ban on the process was in place longer than any other large market in the world despite the Reserve Bank of Australia insisting that it "adds to market liquidity and to the efficiency of pricing, contributing to lower bid-offer spreads and helping to ensure that prices reflect the views of both bullish and bearish investors."

The lifting of that ban is expected to trigger more activity in the market with eSecLending's Awad suggesting "this could provide opportunities for new entrants or existing practitioners looking to increase their presence" while State Street's Squillacioti agrees that "the more flexible a market is, the more activity it tends to attract."

Australia certainly couldn't be described as an emerging market as it is far too developed for that yet, one surprise is that there are not more international custodians and agent lenders offering security lending and custody services given the size of the market.

However, those who are experienced operators in the region believe it has nothing to do with a lack of desire to enter the market, but rather that it is difficult to establish a presence there.

"The main challenge with Australia is that there are some complicated taxation rules and whether it be lending or custodial or administration services, it makes it quite a high barrier to entry," Laurence Bailey, CEO of J.P. Morgan's Worldwide Securities Services business in the Asia Pacific region told Global Investor/isf.

"So, while it is seen as an attractive market, fund managers are able to get into the market more easily than global custodians and lending agents.

"Other players will continue to watch Australia but they will be facing the same challenges that we first encountered when we entered the market at the beginning, some 20 years ago. Global systems need to be tweaked to take into account the local nuances and issues and that is maybe not as easy as people might think. That will slow the execution of going into the market; but the desire from other players is definitely there."

But when a market has the opportunities that Australia does companies tend to find a way to get involved there whether it be through M&A or setting up from scratch. As Squillacioti at State Street says: "It's a market that deserves attention."