

# Press Release



## Hedge Fund Sharks Circle the Fortis Vote, say Reports.

### But is that true?

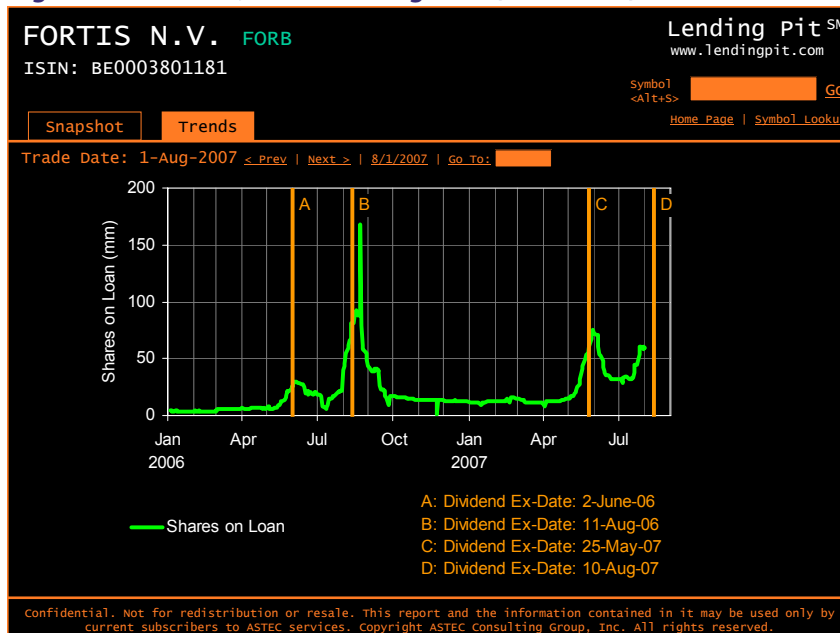
London  
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"It is not illegal for hedge funds to manipulate share prices," said the July 29th *Sunday Times*. "Borrowing stock delivers voting rights at a fraction of the cost, [and] suspicions have been raised that groups of traders are trying to manipulate the outcome of the ABN takeover." (1)

The *Sunday Times* reporter then quoted an unnamed trader who said, "The demand to borrow Fortis [shares] is at an extreme level at the moment. Usually European banks have about 3% or 4% of their stock on loan. Fortis has got at least three times this much." Hedge funds hold 30% of Fortis, continued the *Sunday Times*, and "almost 14% of Fortis's stock, valued at about €5.5 billion, is now being 'borrowed', according to traders using Data Explorers, one of the few systems that track global stock lending."

These statistics suggest the undoubted prevalence of the kind of "dirty tricks" that formed the lead to the *Sunday Times* story. These lending statistics from Data Explorers are taken by the *Sunday Times* reporters to support the rumors that hedge funds are borrowing securities to take control of the Fortis meeting.

Fig. 1: Loan Volume, Jan 2006 - Aug 2007 (20 Months)



### Yearly lending patterns suggest no unusual activity prior to the Fortis EGM

But are those conclusions accurate? Or do the cited statistics actually oversimplify and distort the real situation?

Could it be that the increase in lending of Fortis shares at this time is not only commonplace, but also quite benign – a normal securities lending practice which is being distorted by the statistics?

To answer these questions, we can query another global tracking system for securities loans: the **Lending Pit** platform of *The ASTEC Consulting Group* of New York.

Despite what the papers – or the financial industry websites – say, the intense media interest in recent borrowing of Fortis Bank shares, and related corporate governance issues may be misguided.

On June 29th 2007, Fortis Bank announced that it would be holding an EGM, an Extraordinary General Meeting on August 6th 2007. A 75% approval vote at the EGM would enable the Belgian bank to raise the €13 billion necessary to participate in the takeover of ABN AMRO Bank NV with a consortium of banks of which Fortis is a member. While much retrospective

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(1) Waples, John and Louise Armitstead, "Hedge funds' dirty tricks offer to Barclays," *The Sunday Times*, July 29, 2007

importance has been attached to that move, very curiously, right after the announcement, nothing happened.

Securities lending data from ASTEC's Lending Pit shows that even after this date, the amount of Fortis shares on loan still remained flat, with the change in loan volume actually dipping on July 6 about 10%. From July 6th to the 30th Fortis shares did nothing unexpected, despite increasing speculation in the financial press.

A 15-month graph of lending activity indicates that Fortis Bank shares on loan behaved just as any trader would have expected. At the approach of each of the dividend periods, volume and fees both increased, while rebates fell. Profit possibilities here were routine: when the stock went special, the price charged by lenders who knew about that increase in time, would have gone up. And borrowers would have had to act quickly to catch the market early. That's not unusual.

"Historical analysis on Lending Pit reveals a pattern developing in 2007 in loans of Fortis shares that is nearly identical to what we saw in the summer of 2006," according to ASTEC's managing director Aaron Gerdeman. "Specifically, we saw two peaks of activity – in both rates and volume – around the dividend record dates in June and August of 2006," Gerdeman continues. "We have already seen the June peak again this year for the 'final' Fortis dividend, and now we see the beginnings of another peak for the expected 'interim' dividend in early August."

At each dividend date the volume of Fortis shares on loan increased as

the dividend date approached. Fees also increased while rebates fell thus making the stock more expensive and boosting it into the "special" category. Then immediately after the dividend date, the volume returned to normal, as did fees and rebates. Until the next time.

On July 30th, the volume of Fortis shares on loan decreased slightly, possibly in response to recalls from two large Dutch pension funds, while the loan fee remained steady. At this point agent lenders with this knowledge could have advised their beneficial owners who did not wish to exercise their vote at the Fortis EGM to put the stock into their availability pool to earn extra income, while borrowers could have set up profitable arbitrage strategies.

Several possible scenarios could explain the Fortis stock's movements at the end of July. Some are routine, some are less so. For instance, broker / dealers might be borrowing the stock in order to make their own in-house deliveries or returning unwanted shares. Another possible reason: arbitrage strategies using call options necessitate the borrowing of shares in order to prevent having to close related open positions. Or, borrowing volume could be moving due to the fact that beneficial owners are recalling their positions in order to vote in the upcoming Fortis EGM on Aug. 6th. Lastly, despite problems of legality and best practice in various jurisdictions, and what must also be considered, is the possibility that the volume is moving because borrowers

are building up positions in Fortis to vote at the EGM.

In the last two weeks, the financial press and financial industry websites have carried a spate of stories suggesting that unnamed hedge funds are in fact collecting borrowed shares to prevent Fortis from raising the required capital to participate in the anticipated ABN AMRO takeover. One cited a "huge trade," otherwise undocumented; another said that trades had increased considerably recently,

### U.S. brokers are barred from borrowing to vote

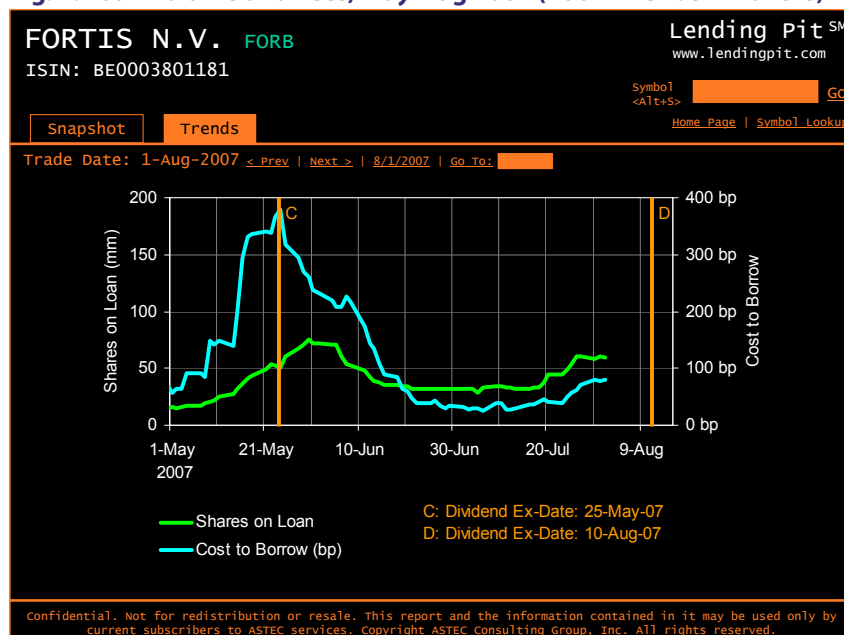
although over what base of trading activity was left unstated. Some sources have even

suggested that call options on Fortis Bank's stock (executed at or near the strike price, and expiring 30-60 days out) will then produce a tidy profit, as Fortis Bank would be forced to leave the consortium after the vote failed to carry the necessary 75% approval, resulting in a rise in the Fortis stock price. Promptly circling the wagons, corporate governance platforms announced that their members were recalling all their shares (.26% in the case of PGGM and "a few tenths of a percent" in the case of ABP) to vote their entire blocks in the upcoming EGM.

Yet an informal canvass of securities lending traders made on July 30th and July 31st in both London and New York revealed no unusual activity in Fortis shares. This is significant for an otherwise unreported reason.

Broker-dealers in the United States are prohibited from borrowing securities for any reason except to comply with one of the "permitted purposes" cited in Regulation T of the Federal Reserve Board. And borrowing shares

**Fig. 2: Loan Volume and Fees, May-Aug 2007 (Zoom View: 3+ Months)**



Shares on loan are increasing ahead of the dividend ex-date, which is four days after the Fortis EGM. The proximity of these two corporate events has been overlooked by most observers.

to influence a resolution is not permitted. Therefore, one can (must) assume that any “vote borrowing” is taking place outside New York. And yet, just as the informal traders’ survey showed no unusual activity, a more intensive survey of Fortis loans on the Lending Pit platform showed no difference in borrowing fees between the US and European markets. Average fees in Europe were about 76 basis points, while the spread on US dollar cash loans was about 81 basis points.

ASTEC’s Gerdeman sums up things neatly: “When I look at Fortis lending activity in different global markets on Lending Pit, I also see that everyone is paying roughly the same rate to borrow the shares. If certain markets permitted ‘vote borrowing’ and owners were willing to give up their franchise, then one would expect higher demand and higher costs in those markets. But we don’t see any jump off the page.”

The ASTEC Lending Pit graph shows that the current movement of Fortis Bank’s stock out on loan is consistent with its activity over the past 15 months, even taking into account the added feature of the EGM. The changes noted on July 30th probably respond to the upcoming Fortis EGM. It seems most likely that the volume of Fortis securities on loan will increase in the next few days, and fees will likewise increase, making Fortis Bank a “special” issue, and rebates will reduce, making the stock more expensive to acquire. But that will only persist in the short term. Then, within five to ten business days, the graph will return to normal until the next dividend period comes around.

What’s the conclusion one can draw from this situation? Data is not intelligence. By looking only at data describing the current volume of Fortis shares on loan, traders had incomplete market intelligence. The sources passed a distorted picture on to financial reporters, who then misinformed the public. Unless securities lending activity is viewed in more significant dimensions, i.e., to include historical and cross-market patterns, neither the market nor its observers will be well informed.

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