European securities lending panel: a meeting of minds

What impact has market volatility, driven by the global pandemic, had on securities lending revenues over the past 12 months?

Dan Copin: The past 12 months were marked by significant liquidity injections from most central banks. Global equities markets have also risen across the board. Securities lending activity has massively reduced, however, and revenues on 'specials', particularly in the US, have shrunk. This was balanced out by a rise in corporate action activity in 2021 where companies raised capital on financial markets via convertible bonds, corporate bonds and rights issues.

Over the past year, we have seen a considerable rise in ETF lending activity where utilisation rates and revenues generated have continually set new records. Cash inflows into the system have also influenced market players' preferences in terms of collateral. In short, where European collateral is principally held in instruments other than cash, we have seen a major shift towards cash.

Maurice Leo: In my view, there has been a noteworthy structural change in buy side evaluation of the hierarchy between securities lending/repo as a liquidity management tool and its traditional use case as a source of revenue.

This has been particularly evident amongst asset owners such as pension funds and some sovereign investors over the past year. For asset owners, the main catalyst was the volatility in market valuations during March and April 2020 that translated into a dramatic increase in the requirement for cash to meet margin calls on their derivatives positions. For sovereign investors, funding demands arose from a sudden and dramatic contraction in the fiscal position of economies that were highly exposed to the impact of Covid-19.

We have witnessed a considerable increase in enquiries from asset owners and sovereign investors regarding how to harness cash collateral raised within their agency programmes — to meet the demand for margin calls in unrelated products or as an alternative source of funding to asset disposals.

Importantly, these clients are often seeking funding assurance through balance sheet-backed commitments from the agent to immunise against potential liquidity disruption resulting from lower bank intermediation in repo markets over key accounting dates or other periods of market stress.

This hierarchical approach to collateral allocation is likely to become more prevalent with implementation of the remaining phases of Uncleared Margin Rules (UMR) over the coming 18 months and will have performance implications for parts of our industry.

Demand for government debt has remained resilient throughout the past 18 months, with balances up 20 per cent in YoY terms. There has also been a meaningful contraction in spreads.

Importantly, as central bank intervention has continued at a pace and scale not previously witnessed, the securities lending facilities of the ECB, and its peers, have continued to serve as an effective backstop, supporting bond and repo market liquidity without unduly curtailing normal repo market activity. These facilities continue to be an important liquidity pillar when market tensions emerge.

Stephen Kiely: The second half of 2020 was challenging. Cash reinvestment returns dropped off as the yield curve flattened and guidance from central banks indicates no rate hikes are likely until 2023.

IPO activity, which has traditionally represented an important driver for generating lending revenue, has come under challenge from Special Purpose Acquisition Companies (SPACs) — companies with no commercial operations formed to raise capital with the purpose of acquiring a public company. SPAC issuance attained record highs during 2020 and then pushed on further with another major surge in early 2021.

Last year also saw large scale capital raising as companies raised money cheaply and built reserves to weather the pandemic storm. Subsequently, 2021 has seen the return of dividends, albeit at slightly reduced levels.

January 2021 saw the meme stocks burst into the picture, with several hedge funds losing substantial sums on GameStop as retail investors battled the hedge funds who held short-interest positions in those securities. This saw a major de-leveraging as hedge funds sold longs to cover losses and closed out additional shorts due to contagion fears.

In APAC the short sale ban in Korea was extended to May 2021, although Malaysia has become attractive to some short-interest traders through shorts focused on PPE manufacturers such as Top Glove.

Demand for ETFs increased, especially in the high-yield space with names such as HYG seeing the largest increases.

Andrew Geggus: Market activity was shaken in the early stages of the pandemic, with some industry participants withdrawing their assets from the securities lending market and multiple jurisdictions implementing short selling bans. This initial contraction was quickly replaced by an injection of liquidity into the market as many central banks implemented emergency asset purchase programmes in response to the pandemic. Balances in high quality liquid assets (HQLA) remained buoyant throughout the pandemic, as has been the trend in recent years.

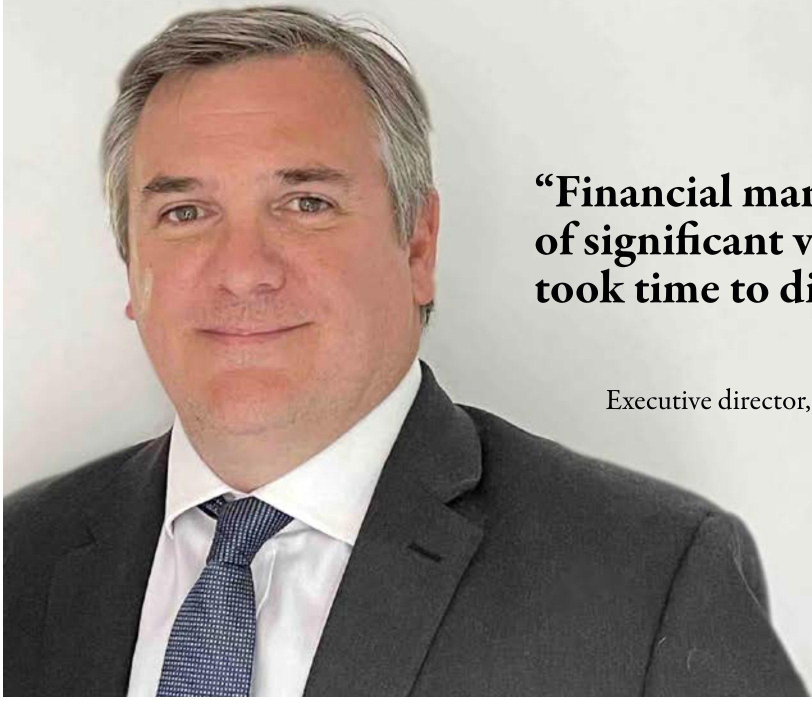
The coordinated central bank action, providing large injections of liquidity, have resulted globally in yield compression across the financial markets. The combination of interest rate reductions, a surge in issuance and massive liquidity intervention have posed challenges for the industry.

These challenges continue today as cash collateral lenders seek yield opportunities, enticing participants to expand their collateral and tenor restrictions to maintain their lending strategies. However, lenders must proceed with caution, ensuring that assets and tenors align with the risk profile and mandate of a lending programme.

Marcus Rudler: The global pandemic sent most countries across the world into lockdown, effectively closing down economies as governments fought to curb infection rates. Financial markets experienced a period of significant volatility as key participants took time to digest longer term direction. This presented both opportunities and challenges to agent lenders. For example, the travel and retail sectors were hit particularly hard and, into the second half of the year, there were more specials and corporate events as companies took steps to restructure their balance sheets.

On the flip side, balances dipped as quant-driven strategies began to deleverage due to the increased volatility. While global revenue (according to DataLend) was up across both equities and fixed-income asset classes by over 20 per cent YoY, the trajectory was choppy through this period.

In response to the pandemic, major central banks stepped in with measures to alleviate stress in the system. They created an ultra-accommodating framework that continues to oversupply liquidity into the market, most notably through quantitative easing. This has driven interesting changes across flow and funding and cash reinvestment. For instance, equity loan balances have grown steadily which can be attributed to up-marks as investors, buoyed by liquidity and a central bank backstop, have driven equity market prices to record levels.



"Financial markets experienced a period of significant volatility as key participants took time to digest longer term direction"

Marcus Rudler
Executive director, EMEA head of agency securities lending trading
J.P. Morgan

Borrower behaviour continues to evolve too, as more thematic and sectoral plays come into focus over specific shorts. We have also seen a rise in demand for ETFs to gain macro exposure and growth in General Collateral (GC) balances across equities and corporate bonds.

Sharing the same ecosphere, the funding markets, including credit, have experienced the same issue of oversupply. Collateral upgrades for instance — where historically the dollar currency basis drove borrowers to pay a premium for cross-currency funding against their non-dollar assets — has slowly collapsed over the last year, prompting a shift in balances and rates.

Even on the 'non-traditional' collateral side (for example, versus equity in reverse repo, which has seen a rise in demand in recent years) the market has become overcrowded with cash holders chasing the same collateral. There was some respite as borrowers moved to optimise balance sheet usage, enabling agent lenders to benefit from a noticeable demand for cash or assets from capital efficient clients.

In summary, securities lending has benefitted and been challenged by the volatility and overfunded landscape brought about by the pandemic and the subsequent response. Overall, balances and revenue are up. However, at the margins mounting headwinds continue to compress spreads to tighter and tighter levels.

This now raises deeper questions around traditional risk-reward payoffs as agent lenders look ahead and evaluate opportunities. It is now more important than ever that businesses seek diversified revenue drivers and rely less on traditional sources.

Sunil Daswani: Typically, volatility is good for securities lending, but the combination of volatility and economic uncertainty we have witnessed recently has had a negative impact on revenues. Loan demand has reduced, with hedge funds deleveraging and short selling bans being applied in some markets. Pandemic 'specials' initially gained some traction, but this has subsided.

However, we have not seen the chaotic days of the global financial crisis (GFC) of 2008-9. Lenders have generally taken a calm approach to managing risks arising from Covid-19 and adjusted their securities lending programmes accordingly. One big change since the GFC is the increased transparency in securities lending programmes, so beneficial owners have a better understanding of their programme and the risk parameters.

Back in early 2020, the industry was optimistic about the potential opportunities in new markets created through regulatory change, including the Philippines, Saudi Arabia, Indonesia, and most significantly, China. Subsequent events have naturally slowed progress in opening up securities lending markets. However, as we go through 2021, emerging markets continue to be an attractive sector, with relatively low levels of lendable supply and additional operational requirements leading to higher returns for lenders, particularly early market entrants.

As we have seen in countries such as South Korea, Taiwan, Malaysia, and more recently, Russia, initial demand often outstrips supply as new markets open up. We are likely to see the same in the coming year in China and other newly-emerging markets for securities lending.

Matthew Neville: At the portfolio level, State Street saw an increase in loan balances across all asset classes over the past 12 months. This can be attributed to enhanced connectivity with our borrowers across our electronic distribution platforms, as well as expansion in our collateral financing capabilities. Despite the increase in balances, there have been revenue challenges.

On the equities side, there has been a distinct lack of corporate activity, so revenue from hard-to-borrow and specials activity, relative to total revenue, has been much lower than in previous years. We also experienced reduced seasonal demand, partly as a result of central bank recommendations and companies shoring-up their balance sheets during the pandemic, but also due to a reduction in the availability of low-dividend supply in some markets, as tax treaty harmonisation continues to reduce differences in withholding rates among beneficial owners.

On the fixed-income side, unprecedented central bank operations in the open market squeezed spreads across the collateral spectrum. However, demand has remained strong and balances are outperforming previous years.

In terms of borrower requirements, we have seen a significant increase in demand for Global Master Securities Lending Agreement (GMSLA) Security Interest (Pledge), largely replacing that for central counterparty clearing houses (CCPs) as a faster route to market.

Borrowers are also more prescriptive about the type of lending client they want to face, placing more value on certain client types over others. This is mostly driven by the need to deploy their financial resources more efficiently as the capital treatment varies considerably depending on who they transact with.

This has led to borrowers asking us to group clients into ‘smart buckets’ of their choice — for example, low-risk weighted assets (RWA) clients only. We see this trend continuing to play out as they consider other factors, such as position stability from clients following Environmental Social & Governance (ESG) strategies, or when facing other financial resource constraints such as the Net Stable Funding Ratio (NSFR).

Major regulatory projects such as the Securities Finance Transaction Regulation (SFTR) have prompted the industry to reflect on its operational practices, but many non-standard processes remain. What are the implications?

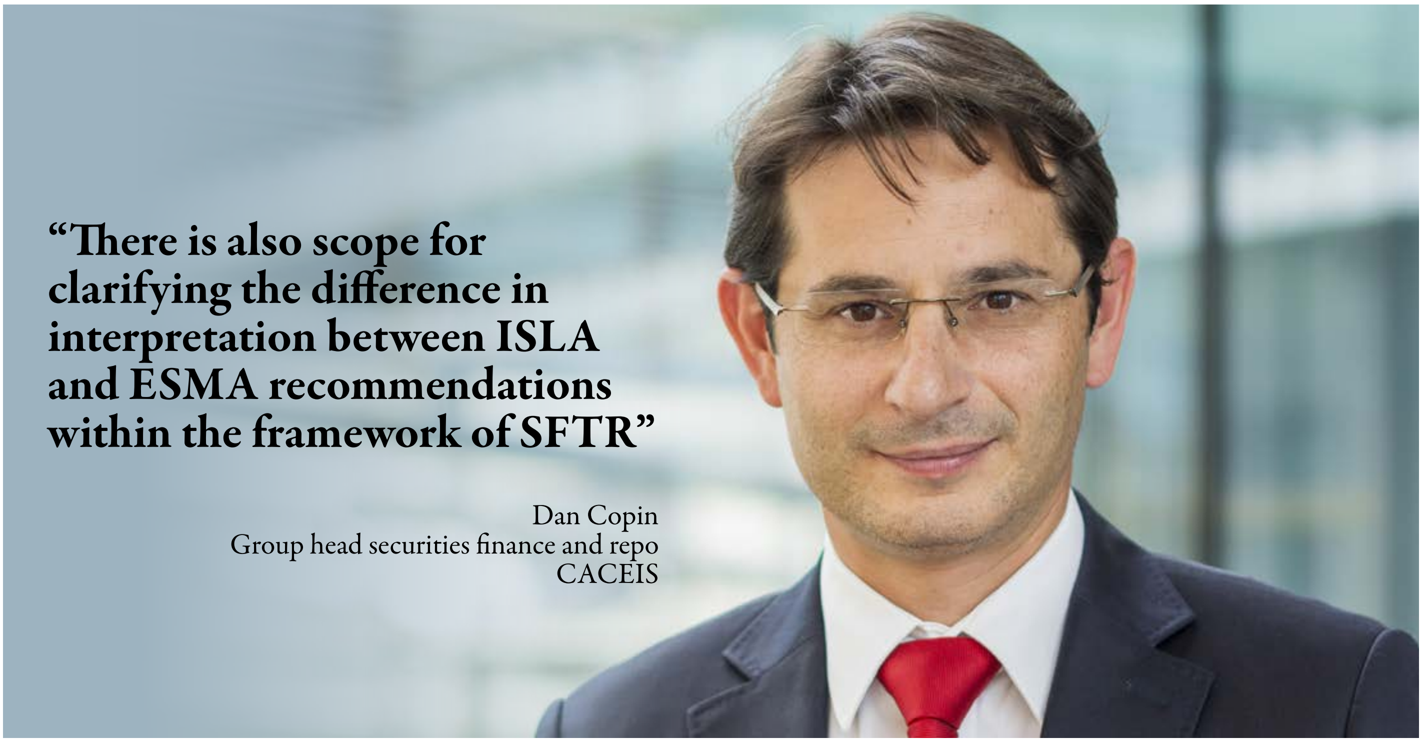
Kiely: SFTR has required that a number of firms review their operational practices, especially around data management. In some cases, whole databases have been built to facilitate this regulation and this exercise has been largely useful in standardising programme parameters.

This will aid the International Securities Lending Association (ISLA) in its efforts to lead the market in providing data vendors with standard data and programme parameters, allowing beneficial owners to compare performance in a more meaningful way with greater accuracy. There is always a tradeoff between scale and standardisation, and bespoke practices and processes, but the increased synergy within firms arising from some of these projects will benefit the beneficial owner in the medium and long term.

Copin: From an operational perspective, regulation could definitely play a part in clarifying the complexity inherent in products such as bank loans or the management of transaction events like those in an agency lending programme. There is also scope for clarifying the difference in interpretation between the ISLA and the European Securities and Markets Association (ESMA) recommendations within the framework of SFTR.

In particular, it would be preferable to have greater flexibility around the timing permitted to report the transactions. It would also be useful to have some reduction in these obligations for medium and smaller-sized market participants — these present a financial barrier that may shut them out of securities lending and repo markets or force them to take an expensive outsourcing route.

Neville: There are robust legal frameworks in place today across the



“There is also scope for clarifying the difference in interpretation between ISLA and ESMA recommendations within the framework of SFTR”

Dan Copin
Group head securities finance and repo
CACEIS

globe to support securities lending transactions and these have stood up to the test through times of counterparty default.

The SFTR regulation focused the market on collecting, holding and reporting lifecycle events on securities finance transactions, and although SFTR is a European regulation, it reached all aspects of the business and clients globally.

Both SFTR and the pending Central Securities Depositories Regulation (CSDR) are encouraging parties to improve efficiencies, including reconciliation of positions, pre-matching, and maintenance of Standard Settlement Instructions (SSI). This will ultimately lead to standardisation as participants look to drive down and manage costs.

Another key development for securities finance has been to align with ISDA to work towards the development of a common domain model (CDM). This will drive further standardisation of contracts and trading practices. While this is not following an explicit regulatory requirement, it will enable the industry to operate more effectively in accordance with the regulatory regimes already being implemented.

Rudler: Efforts over recent years to promote consistent approaches to regulation have been useful, and it is important for regulators to continue their work in this area to ensure consistency of application and to bring other jurisdictions into the current framework. For example, regulators should ensure that requirements around use of legal entity identifiers (LEIs) are applied consistently.

Daswani: Digitisation will be key to regulatory and market endeavours to drive standardisation and efficiency. We are already seeing positive developments from the European Commission and national regulators. However, these efforts are typically a little behind evolving market practice. For example, securities lending is already advanced in the use of technology, with more than 90 per cent of securities lending trading volume now done through automated lending platforms, a shift that few would have anticipated 20 years ago.

The CDM also appears to be gaining traction within the industry. Standard Chartered remains committed to supporting this initiative as ISLA drives this forward.

Leo: There is a need for greater convergence in regulatory approaches towards ESG investment. This would be appreciated by all securities lending market participants globally. The more harmonisation we can establish around eligible ESG collateral constituents, the better. This is important to avoid marginalising supply and liquidity.

On the other hand, I think regulatory divergence will increase as the UK government continues to evaluate existing and new financial services regulation against the backdrop of the reinforced sovereign integrity evident since January 2021.

As an industry, I believe we have a good track record in promoting standardisation practices — I think of the significant improvements in daily performance, counterparty and collateral exposure reporting for example. These were initiated by the ETF sector during the last decade and have been adopted more broadly by other regulated products over time.

In a similar vein of self-improvement, we support ISLA's continued promotion of a CDM in the securities finance industry. Through industry collaboration, we can accomplish a substantive transformation in how we negotiate documentation and manage transactions through greater standardisation.

Which regulatory projects will have the most impact on your business in the coming 12 months?

Daswani: Regulators recognise that securities lending has become increasingly integral to financial markets as a source of liquidity and financing, as well as efficient price discovery. Their focus now is to promote transparency and alignment between market participants to reduce market risk and increase efficiency.

Data is key to this, as we have seen with implementation of SFTR reporting that took effect in 2020. In addition, the CSDR, which aims to harmonise timing and standards of conduct in the European securities settlement industry, will also have an impact. But with implementation delayed to February 2022, the effects are not yet clear.

Neville: SFTR will continue to develop as booking processes are harmonised across the industry and participants improve their pairing and matching, reducing the number of breaks that require support and investigation.

CSDR is approaching at speed. Borrowers and lenders have a shared interest to increase settlement rates and reduce fails and penalties.

However, the expectations members place on each other will differ depending on the infrastructure they have in place and their ability to connect with the central securities depositories (CSDs) and post-trade service providers.

State Street is working to ensure we shift the balance of operational support from post-settlement to pre-settlement to minimise fail rates. SFTR has prepared the groundwork for this and connectivity with post-trade vendors will help to identify those trades with the highest potential risk of penalties.

Additionally, SFDR has introduced specific requirements for our lending clients which will help to develop the framework for ESG.

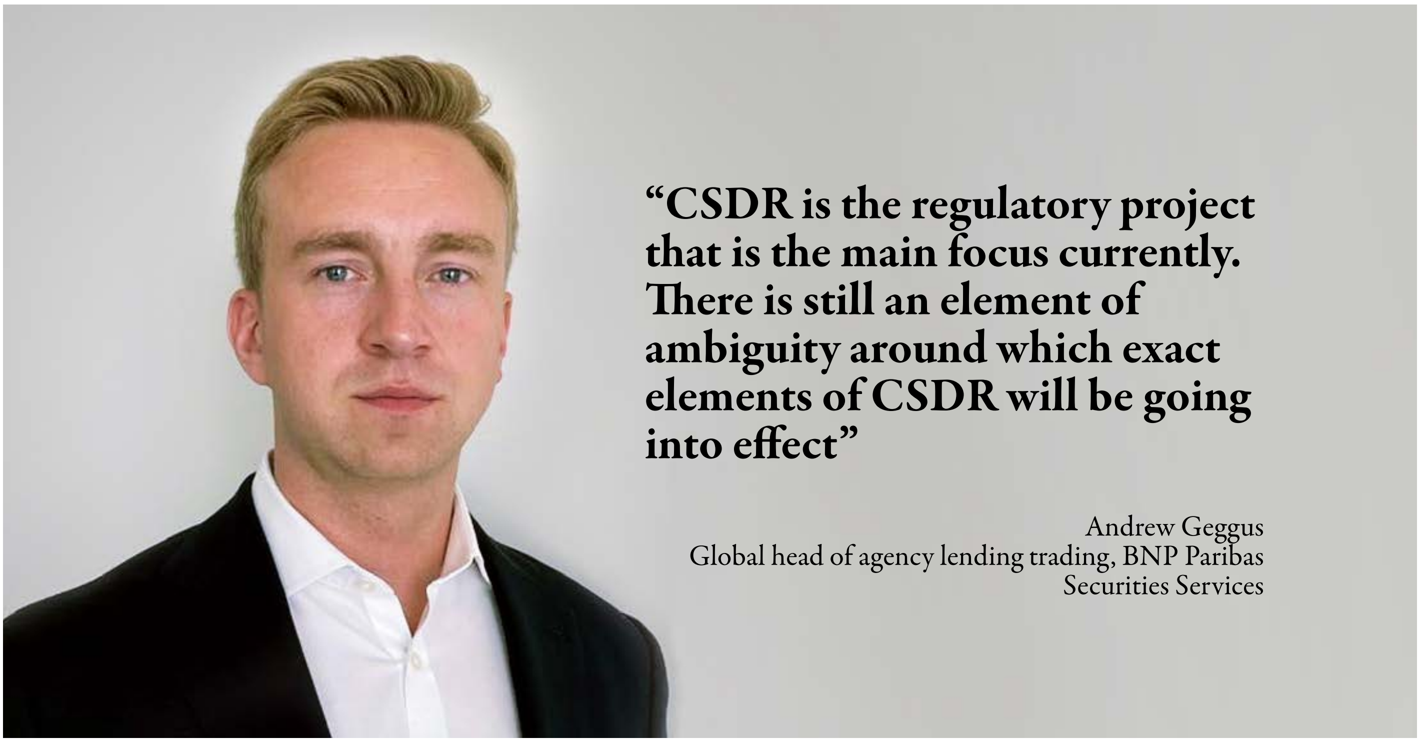
Rudler: There doesn’t appear to be any let up in the regulatory timetable over the coming 12 months. The ESG agenda is clearly going to dominate – with the remainder of the Sustainable Finance Disclosure Regulation (SFDR) still to implement, coupled with updates and amendments that will add an ‘ESG overlay’ to existing regulations such as UCITS, AIFMD and MIFID. In addition, the roll out will start for the EU Taxonomy Regulation.

It is also worth noting that a number of ‘milestone’ regulations – such as AIFMD, UCITS, MIFID and SFTR – are all scheduled for review over the coming 18 months.

Copin: The CSDR will be the major topic for us, requiring major effort from all market participants but, at the same time, increasing the safety and efficiency of securities settlement in the EU. Nevertheless, we have a good handle on the situation and are confident that we will have everything in place to ensure our activities are in full compliance by the deadline.

Geggus: Likewise, CSDR is the regulatory project that is the main focus currently. There is still an element of ambiguity around which exact elements of CSDR will be going into effect in February 2022. Many industry participants have responded to the European Commission consultation requesting that buy-ins become voluntary and that their implementation is delayed. Despite the uncertainty around the final structure of CSDR, we are approaching the implementation in the same way we handled SFTR. A dedicated team is responsible for monitoring the regulation and ensuring each business is adequately prepared to address the variety of challenges presented.

As part of our preparations, our agency lending team plans to use internal resources within the bank to mitigate settlement fails. For



example, utilising our affiliate counterparty network and the fail coverage programme offered by our affiliate BNP Paribas entities could help our clients comply with CSDR.

We are monitoring the developments around CSDR extremely closely and are preparing for the implementation. Our active involvement in industry associations such as ISLA and the Risk Management Association (RMA) provides a forum for us to work with the appropriate regulatory bodies.

The role of the agent lender is being pushed upstream in buy-side decision-making processes. Data and insights from securities lending are becoming more integral to investment decision-making — particularly as firms apply ESG overlays to their investment strategies. How does this affect your business ?

Geggus: The securities financing industry continues to play an intricate role in the performance of a beneficial owner's investment portfolio. The securities lending agent is now viewed by many prominent beneficial owners as an extension of their asset management vendor list. Agent lenders have welcomed this change in mindset as agents continue to deliver unique solutions addressing the needs of a beneficial owner.

Whether generating liquidity, offering solutions to invest excess liquidity or utilising the numerous networks of counterparties and vendors to share market intelligence, beneficial owners are leveraging the experience and market expertise of their lending agents.

ESG is a prime example of the ever closer relationship between an agent and beneficial owner to implement the portfolio management strategies of a beneficial owner. Access to ESG data, either proprietary or through a vendor, continues to strengthen the connection between an agent and beneficial owner while highlighting the importance of an engaged, sophisticated lending agent.

Kiely: As suggested, securities lending has been getting closer to the investment decision making process for years, but this has accelerated with the focus on ESG investment strategies and decisions. A firm is only as effective or compliant as its weakest spot. Therefore, any extra intelligence or information that the securities lending market can provide to the investment decision makers is a welcome addition to the process. As the source of ESG compliance is the investment decision, this drives all other downstream businesses and events. As you suggest, the closer businesses are, the easier it is to overlay a strategy.

A second point is that we have been in a low interest rate, low yield environment for so long. Therefore, any extra revenue that can be derived from securities lending is attractive to the fund manager — especially if this assists them in achieving or beating a benchmark. The more an agent lender can understand a client's investment choices and form a two-way relationship, the greater the securities lending revenue potential.

Copin: We do not entirely agree with the question's premise because in our experience with clients, buy-side decision-making does not take securities lending data or insight into account that much. We actually see it occurring the other way around, where the lending programme is adapted to the clients' potential decisions.

Portfolio managers want to make their decisions without having to integrate securities lending considerations because in their opinion such activity ought to be transparent for the fund. As far as ESG is concerned, we generally observe that lending activity must comply with the firm's internal practices such as recalling securities for a General Assembly or excluding certain specific types of collateral. The agent lender definitely provides some data and insight to clients to help them understand where they ought to be cautious and, if necessary, to adapt their lending programme.

What data and tools are you providing to buy-side firms to support their front-office investment decisions and help them fulfil their responsibilities as shareholders?

Geggus: There are a variety of clients in the BNP Paribas securities lending programme, each with a unique strategy and risk profile. We work closely with our clients to customise their programme in accordance with their goals, whether that be from a risk and returns perspective or in relation to a particular focus such as ESG. Our role is to understand their objective and have an open dialogue to demonstrate the impact of ESG within their securities lending strategy.

We are cognisant of all factors throughout this process so our clients can decide the best course of action, accounting for the impact on their programme as they proceed in this journey. We provide detailed analysis to prospects, highlighting the result from the implementation of restrictions on programme loan balance, borrower demand and ultimately revenue.

Part of our analysis highlights the economic benefits of lending in this ESG-focused environment. We want to ensure that clients recognise the economic benefits so they are armed with the necessary information to conduct a proper cost-benefit analysis throughout the process.

This is delivered through our dedicated reporting suite, as well as customised information on request from our front office and market specialists. Having access to the whole BNP group allows us to tap into areas of knowledge and tools that we have within the bank that perhaps aren't directly part of our agency lending business.

Kiely: We have recently updated our reporting suite and are currently rolling it out to all clients. We have developed a reporting dashboard which allows clients to understand quickly and intuitively where the concentration and exposures are within their programme — through visuals and heat maps which show the makeup of collateral, borrowers, asset classes on loan, and so on. Using this dashboard, a risk-reward snapshot is immediately available. As risk committees and front office teams take a greater interest in securities lending, this provides them with an immediate insight into the programme.

Daswani: There are several indices already available to support investment decision-making around ESG, such as MSCI UK IMI Low Carbon SRI Leaders Select index which tracks small and mid-cap UK entities with high ESG scores. However, there is still a long way to go in establishing a consistent way of measuring and comparing fund performance at an industry level.

One challenge is that investors have different ESG priorities. Some investors will prioritise carbon emissions, while others will look at issues such as energy consumption, pollution, corporate governance, and diversity and inclusion. This creates an enormous demand for a wide range of data, which needs to be monitored and tracked over time.

However, we are seeing various initiatives emerge to develop ESG measurement and comparison tools, both amongst individual providers and at a wider industry level. One of the most promising is the Global Principles for Sustainable Securities Lending (Global PSSL) initiative. This aims to create a global ESG market standard for owners, lenders, borrowers and impact creators.

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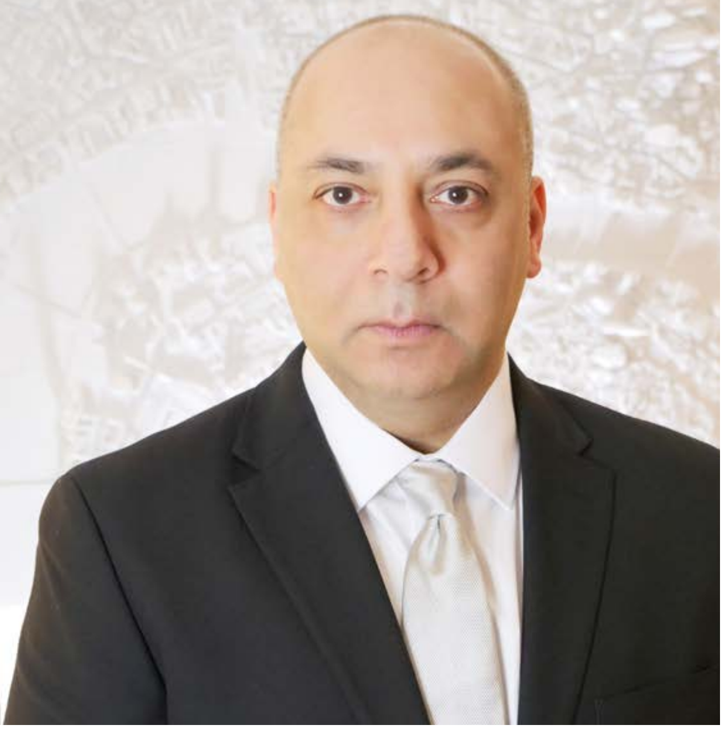
Sunil Daswani
Global head of securities lending, financial markets
Standard Chartered



ESG considerations extend beyond stock selection. For example, asset managers also need to apply the same ESG criteria to their collateral. Where cash or some fixed income securities are posted as collateral, this may not be a significant issue. However, where equities are used for collateral, we provide a collateral filtering and ongoing monitoring service to give asset managers the assurance that their investors' ESG priorities are reflected from end to end through the securities lending process.

Given that an investor cannot participate in shareholder votes (typically via proxy) when they have lent a security, they may decide to recall a security to allow them to do so. This issue resonates specifically for ESG-driven investment, where institutional shareholders may play an important role in defining a company's ESG strategy. Our configurable, automated share recall service enables clients to make informed decisions on whether to recall securities or leave them on loan. This service helps reduce the opportunity cost by limiting the frequency of recall, and the time period for which securities are removed from the lending programme, whilst enabling investors to engage on key strategic issues.

Neville: ESG continues to be a hot topic for discussion with clients. State Street recently launched an ESG-aware cash reinvestment vehicle for certain customers and we are working on setting up a foundational ESG non-cash collateral index.

For clients wanting to actively shape management decisions in the companies in which they invest, State Street can manage client portfolios around key dates, such as Annual General Meetings (AGMs), by restricting or recalling securities should clients want to proxy vote on important issues.

State Street also offers research and data analytics through State Street Associates, and recently published a white paper commissioned by the RMA entitled, "Integrating ESG Considerations into Securities Lending," which proposes several best practices to help agent lenders and asset owners align lending programmes with their ESG objectives.

Rudler: Client experience is at the heart of the business strategy and the focus is on making client interaction as seamless as possible with the use of innovative technology solutions. We continue to digitise the client experience, with particular focus around the ability of clients to control their lending programmes efficiently. JPM clients are able to view and adjust programme parameters electronically.

Additionally, clients are requiring more real-time visibility in their securities lending programmes and access to data is key. JPM has real-time API connectivity where clients can either push or pull data around their programmes and feed this into their systems to get detailed understanding of their programme performance and key risk oversight.

Another focus has been to give clients greater visibility into how changes that are being proposed could affect their programme. JPM has designed a "What-if" scenario analyser tool, which is accessed via J.P. Morgan Markets, which allows clients to model potential revenue impact resulting from changes they make to their lending parameters. This tool enables clients to make informed risk-adjusted decisions within their programme.

Copin: As custodian, we provide an extensive set of activity reports that cover transactions, collateral received, billing and many others. All these files are available for download via the web or can be sent out at the frequency the client requests. We also generate performance reports (benchmark reports) so clients can verify that their agent lender is truly optimising their portfolio. Finally, we hold periodic reviews with clients to run through the latest OTC market trends and potential strategies to increase the programme's performance.

Beyond what we have already discussed, what are the key issues for the securities finance community in driving ESG integration across the transaction value chain? What obstacles exist to advancing this agenda?

Copin: As ESG rises in importance, harmonisation of ESG guidelines for securities lending becomes essential both to ensure players benefit from sufficient clarity for operation, but also to give comfort to market participants that may otherwise decide to cease the activity.

It is important to avoid the issues triggered by stock recall en masse at AGMs, which causes liquidity issues that could be very damaging for the industry itself. Obviously, IT tools play a key role in ensuring compliance with all identified ESG strategies, including fine-tuning of security exclusions, integration of essential market data to optimally monitor all AGMs and other such tasks.

Daswani: We've already discussed issues such as ESG metrics and monitoring, collateral and share recalls and proxy voting, which for many borrowers and lenders remain the challenges to incorporating ESG values from end-to-end. However, with our data-led approach to share recalls and the ability to define collateral rules, these issues should no longer pose obstacles.

Leo: We are harnessing our investment and collaboration with third-party specialists to enhance the servicing of shareholder events and to mitigate the financial and reputational exposures associated with settlement delays.

Consider our consortia investment in Proximity, a platform that delivers transparency and timeliness benefits in the circulation of investor communications and electronic proxy voting. These issues are at the core of the Shareholder Rights Directive II and affect both our securities lending and asset-servicing clients.

Data and automation are also being used to address operational efficiencies in the securities finance market and play a critical role in enhancing trading and post-trade efficiencies. In this context, our adoption of the Elastic Stack will enable our clients to identify in-flight security transactions at risk of settlement delay, thereby supporting compliance with CSDR requirements and reducing the potential costs of penalties and buy-ins for late settlement.

In terms of investor governance, beneficial owners now widely characterise securities lending as an investment product.

This has increased scrutiny around the quality and uniformity of the data underpinning independent performance measurement tools and the presentation of outputs in a transparent and consistent manner. Increasingly this is translating into adoption of performance measures that are customary in the investment management arena. In this context, a word of credit to the ISLA Securities Lending Performance Measurement Working Group, chaired by Scott Baker of ADIA, for the publication in late 2020 of industry standards and best practice guidelines in respect of data aggregation and calibration.

Increasingly we are facilitating direct access for buy-side clients to these detailed performance diagnostics, enabling them to measure revenue attribution and opportunity costs associated with different programme parameters such as security restrictions and collateral parameters.

It is encouraging that securities lending industry data is now used by a diverse series of financial services participants such as cash traders and transition management desks accessing aggregated data to measure the liquidity characteristics of individual securities. Buy-side portfolio managers commonly use the data to inform portfolio construction

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Maurice Leo
Director, agency securities lending
Deutsche Bank

decisions, coupling the securities lending returns alongside low-yielding HQLA holding to establish the total value associated with ownership.

Buys-side investors also find value in securities lending data as a proxy for short selling interest, enabling them to evaluate negative market sentiment towards sectors or individual names.

Neville: One of the main challenges is that each asset owner/asset manager has their own interpretation of ESG, ranging from those companies in which they are willing to invest, to the individual collateral securities they are willing to accept.

This presents challenges to lenders when we think about how we would manage collateral, as you could, in theory, have different collateral eligibility criteria for every client in the programme. This would also have a knock-on effect for borrowers, potentially increasing the number of Required Values (RQVs) to collateralise as well as reducing the pool of inventory they are able to deploy. As the ESG agenda evolves, I envisage the market will adopt a range of ESG collateral indices to which lending clients would enroll, enabling some level of standardisation across lenders, borrowers and the tri-party agents.

Geggus: We believe there needs to be a clear distinction between the ESG elements affecting the securities lending and financing market participants, and those of our beneficial owners. There is some fantastic work being done by many industry bodies, as well as industry participants themselves, in looking for how to best incorporate important ESG factors into their service offers and their business more broadly.

We are proud of what the bank is doing to be a leader in this space. When it comes to our beneficial owners, we are of the view that we, as an agent, are there to work with them as a trusted partner and help them shape their programmes around their ESG goals. It is not for us to tell them what to do, but to work with them to come up with solutions to achieve their aims.

The main obstacle to all of this is that there is no “one size fits all” solution when it comes to ESG. This really is a matter of managing the customisation of the lending programme, the idea being to apply ESG parameters while retaining as much revenue as possible from the activity.

Rudler: There is a need to dispel the reservations that securities lending is a barrier to effective shareholder engagement, or that securities lending is incompatible with ESG investing. We firmly believe that the two can co-exist and investors can engage in a securities lending programme without impeding responsible voting and stewardship criteria.

As mentioned, ESG means different objectives to different people (regional divergences, different investment strategies, variances by client type). Therefore standardisation is unrealistic, especially in relation to collateral and lending. Customised approaches will add complexity and friction to the operational process. The key will be to find solutions that enable the industry to balance customisation with efficiency and scale. In our experience, while ESG clearly remains a widely discussed topic, we are not yet seeing it come through from clients in their decision making, outside of voting.

A plethora of data providers, but no harmonised criteria or consistent interpretation with respect to ESG data and ratings, makes it very challenging to assess data for quality and to ensure reliability. This is an important point given how critical a role data vendors play in the ESG ecosystem.

Kiely: Regulatory requirements on ESG are evolving rapidly but are not yet fully drafted and vary across regions, so we are likely to see significant changes over the next 12 to 18 months. At present lenders do not have clarity on what will be required of them. SFDR is a good example of market confusion on definitions owing to lack of clear regulatory technical standards (RTS).

Importantly, securities lending desks are not setting the ESG policies, they are consuming policies coming through from their enterprise ESG — and their enterprise ESG policies, in turn, are not yet at a full stage of maturity and do not take into consideration factors like collateral for securities lending. The result is that these adopt a broad brush approach, applying their ESG policies across everything, including collateral, despite there being no voting rights in the collateral, no legal ownership of pledge and no regulatory requirement to do so at present. For many companies, this strategy is driven largely by a desire to minimise reputational risk.

Beyond what we have discussed, what are your strategic priorities as a global agent lender for the 12 months ahead?

Rudler: Securities lending is an industry which, for most, has altered little in over 40 years, with actors fulfilling the same unchanging roles in a linear value chain. At the same time, clients' financing requirements have experienced rapid structural change as their businesses (and the constraints they encounter) evolve. These trends have challenged the status quo and raised the potential for innovative synergies across the entire secured financing landscape.

We believe alternative financing will continue to grow within the securities lending landscape. We will continue to invest in our dedicated alternative financing team, whose product set expands beyond the traditional securities lending services, and to provide the infrastructure to facilitate all aspects of a client's evolving financing requirements. This includes supporting long and short cash trading requirements, enabling lender-directed lending transactions of any kind, and through our Agency Prime platform, supporting loans to non-traditional counterparties such as qualifying hedge funds, or indeed any other peer-to-peer transactions.

Leo: In addition to our established agency product that delivers tailored risk-adjusted returns to our clients, we will continue to reinforce the relevance and sustainability of the business across Deutsche Bank's Corporate Bank by harnessing the opportunity to provide liquidity solutions to treasurers operating on behalf of asset owners or corporates.

Regulatory changes, such as the expiry of Supplemental Leverage Ratio reliefs in the US in Q1, have resulted in a significant displacement of cash into money market funds and repo — established investment options that are widely used within our existing agency securities lending business. We expect to witness continued momentum in our outsourced liquidity solutions activities as investors optimise liquidity management and contingency frameworks and de-couple these from the safekeeping and settlement services of traditional securities services providers.

Copin: As always, our priority is to assist our clients with their business development objectives, to help them to grow and take advantage of new market opportunities. It is essential that we maintain sufficient flexibility, to constantly adapt our ways of working to ensure we generate optimal performance during the Covid-19 pandemic and in its aftermath.

Neville: Meeting our regulatory obligations and looking for solutions in the ESG space are permanent fixtures on our priority list. In addition, with Basel III in sight, developing solutions to

"From a connectivity perspective, we continue to explore and adopt new platforms to expand our distribution capabilities"

Matthew Neville
Managing director and head of agency lending trading, EMEA
State Street Global Markets

manage our financial resources efficiently, as well as those of our borrowers, will be a key focus over the year ahead. The trend for borrowers requiring the GMSLA Pledge is gathering pace and we intend to ensure coverage across all our tri-party providers, enabling borrowers to retain control of their liquidity at their venues of choice.

From a connectivity perspective, we continue to explore and adopt new platforms to expand our distribution capabilities and we aim to maximise utilisation of the post-trade service providers to increase operational efficiencies and minimise risk. Looking further forward still, State Street recently launched a new division dedicated to digital finance called State Street Digital. We're excited to see how we can integrate securities lending into this space as we build out our blockchain and tokenisation capabilities.

Kiely: We have an ongoing commitment to enhance client experience and we are doing this on two fronts in the year ahead. One is through roll out of the interactive reporting tool and development of industry leading ESG capabilities. We are also looking to increase flow through capital efficient distribution channels and trading technology solutions. Ultimately our strategy is to increase capacity through greater intrinsic inventory and wider distribution.

Daswani: We continue to build a values-led business based on best-in-class operations, risk management and governance, and attractive returns, that offers clients a real alternative to traditional securities lending agents, not only in developed markets where securities lending is well-established, but in newer, emerging markets too, such as Saudi Arabia, Indonesia and China.

Securities lending has become a volume-driven business, which has increased market participation on one hand, but also led to a "one-size-fits-all" approach which does not meet the needs of all institutions. Beneficial owners are seeking the flexibility to run an individualised programme that addresses its unique securities lending requirements, in which ESG considerations increasingly play a part.

Traditional securities lending agents often struggle to adapt legacy systems and processes in line with changing regulations and client expectations. Through our agile, flexible and robust agency securities lending service, we are supporting clients' growing demand for digital, automated and highly efficient front-to-back solutions.

The securities lending market continues to evolve, such as the growth in peer-to-peer (P2P) lending that we are currently witnessing, with investors lending to each other rather than through

"Traditional securities lending agents often struggle to adapt legacy systems and processes in line with changing regulations"

Stephen Kiely
International head of securities finance sales and relationship management
BNY Mellon Markets

an intermediary. This approach can help improve trade execution terms, and ensure the credit quality of the counterparty. However, there can be additional operational and legal demands, so we continue to expand our bespoke offering to support these changing demands, without compromising on operational integrity and risk management discipline.

At Standard Chartered our top priorities for the next 12 months include continuing to work with the technology available to see how we can enhance our product offering further to our client base. Our philosophy reinforces the need for client customisation, which we are able to offer owing to the unique structure and set up of our clients' lending programmes which operate on a fully segregated basis. The partnership we have with eSecLending continues to be fruitful, with a strong track record and global presence allowing clients to see the immediate benefits of asking us to review their programmes — offering an indemnity backed by an exceptionally healthy balance sheet and a track record.

Geggus: Some of the main strategic priorities we are working on include an upgrade to our trading system, as well as a continued development plan for our proprietary-built front office layer, which we see as a key driver of efficient performance.

Our upgraded trading system will allow for a lot more flexibility in a market where more data than ever is required instantaneously and at point of trade. We will be able to offer a higher level of customisation to our clients and to our counterparts, as well as an extremely efficient automated route to trade.

Elsewhere, we have been investing in our people. Our presence in the APAC region continues to grow as we leverage our presence in Hong Kong and Sydney to distribute assets efficiently in the region. Our US desk continues to secure new mandates from both asset managers and insurance companies, while the team in EMEA solidifies BNP Paribas as a market leader servicing prominent beneficial owners.