European Beneficial Owner Roundtable 2022

Global Investor/ISF met with some of the key participants in the European securities financing space on February 9 at a venue in central London to discuss some of the key themes and trends which have dominated these markets.

The following pages feature written highlights of the discussion, which centered on five main topics: setting the scene, regulation, technology, ESG and final thoughts. A video of each discussion can be viewed at the end of each section.

PARTICIPANTS

Chair: Amélie Labbé, Managing director, News & Insight, Global Investor Group

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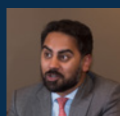
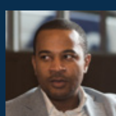
Nick Davis, Executive Director, EMEA Head of Relationship Management, J.P. Morgan Agency Securities Finance

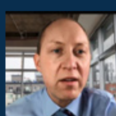
Andrew Geggus, Global Head of Agency Securities Lending, BNP Paribas



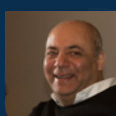
Zorawar Singh, Global Head, Agency Securities Lending, Deutsche Bank



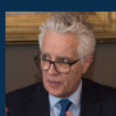
Ernst Dolce, Head of Liquidity Solutions, AXA IM



Matthew Chessum, Investment Director - Securities Lending, Collateral Management, Money Markets, Abrdn



Sunil Daswani, Global Head Of Agency Securities Lending, Standard Chartered



Andrew Dyson, CEO, International Securities Lending Association

Stephen Kiely, International Head of Sec Fin Sales and Relationship Management, BNY Mellon

1. Setting the EU scene

Stephen Kiely, BNY Mellon: 2022 we see as being a year where there's going to be some giving and some taking. We're seeing no real directional shorts in the market right now, and it's benign from that perspective. That's on the equity side.

On the fixed income side, the rate hikes are going to help in the US and in the UK. German bunds are still strong - they're always there or around that level. But with some things, we're still not back to a sense of normal. I think scrip levels are still down, most people are still seeing that and that hasn't come back from its pre-COVID levels. We're expecting dividend distributions to be up more this year, now that those bans have firmly gone away, and things should be looking up a little bit. If there's any light coming, it will be in M&A and general corporate action activity. If we were sat here this time last year, we probably wouldn't have been talking about Naspers and Vivendi, which turned out to be the two biggest specials in Europe last year, so I wouldn't be surprised if there wasn't something like that at some point this year.

Nick Davis, J.P. Morgan: We know that securities lending caters for volatility. As already mentioned, 2021 was a good year for the industry with an increase in balances and flow as the benchmark providers have shown, but at the same time, there has certainly been changes in the marketplace.

For example, in the US, hedge funds were rotating out of tech and more into index-based names especially in Europe. From that perspective, when the primes are looking to cover their shorts, you're looking at internalisation first before going to the agent lenders. Therefore could we have seen more balances if this change hadn't happened?

If there's any light coming, it will be in M&A and general corporate action activity.

Stephen Kiely

From a corporate action perspective, it was again very positive. 2021 saw an increase in SPACs out of the US, IPOs, cap raisings etc. During that period, we also experienced the Meme phenomenon, with hedge funds. This impacted directional specials because of the disclosure rules that were put into place. Although 2021 was a good year, could we have seen more special activity?

As already mentioned, there has been a change in fiscal policies, an increase in interest rates, and a shift in asset allocation, moving away from equities and more into fixed income. It will be very interesting in the specials space following the shift in asset class, and in 2022 we may very well see more demand in corporate bonds than equities.

Finally, from a volatility perspective, we saw record sales last year, so it's very much around liquidity management and making sure that the trading desks are focused on this to ensure a timely settlement. We have algorithms in place as I am sure other agents do to manage this process.

Sunil Daswani, Standard Chartered: From the perspective of Standard Chartered, our model is slightly different to some of our peers. Therefore, we do sometimes see different opportunities. At this point in time, the opportunity is like what we've always said: it's looking at credit and duration risk. And we're certainly seeing in the US Treasury market that great opportunity can be achieved from the lending of US treasuries of clients looking to take on lower forms of collateral, equity collateral, and also lending on a term basis. This takes education. It's something that we are very proud of - what we've done as an industry over the last few decades, and coming out of the global financial crisis - to ensure that if you're asking clients to take on risk, they understand that that risk comes with a reward, but it's a risk that they're aware of.

The other thing that we see in our model, which is slightly different - and we do look and focus very much on the specials activity, which is where the industry is going – are in particular premiums in auctions of exclusives in the right markets, particularly in emerging markets, or emerging developed markets like Taiwan and Korea. What's quite interesting when we've seen these premiums of recent clients is that they are making a lot more than what they would do if they were in an open discretionary programme.

Finally I'm hoping at this roundtable that we'll see that the traditional model of securities lending is forever evolving. We've talked about this a lot. But we're actually now trading in this way for certain clients where they wish to raise cash: we lend their securities, we take the cash in, and we actually give it to our clients to manage, which is what they've needed, and they've asked for a long time.

Zorawar Singh, Deutsche Bank: 2020 was a catalyst for me. COVID was a period of volatility. Liquidity was a top priority for a lot of clients and this, in effect, opened some clients' eyes to what it can be used for – securities lending, but more so in the fixed income space. I don't think you'd see a lot of equity lenders come out and say: 'I am taking the cash collateral back'. But to us, it doesn't matter, right? I mean, we do our day job, we've got desks that cover all aspects. So as far as cash is concerned, it's down to process, and to optimising how you manage that cash.

Ernst Dolce, AXA IM: On the beneficial owner side, we saw a couple of things.

In 2020/21, the discussion with clients shifted from monetising their assets to also removing the liquidity trap that we have seen on their balance sheets.

For the collateral, the European market is mainly non-cash collateral which is the opposite of the US (eg Europe: 80% non-cash collateral and 20% cash collateral versus US 20% non-cash collateral and 80% cash collateral).

So currently, the focus is more on the cash because there is no pickup in the market negative interest rate environment, and you need to monetise the cash. When increasing the cash under the securities lending format, you can reduce the cost of cash sitting on your balance sheet, as this is expensive and the fund gets charged by the custodian. We have clients looking for a solution where they don't see securities lending as just one pillar - lending the assets - but how they can reuse the assets across all their activities to make money or reduce their costs.

I would leverage the point about US Treasuries. At the end of last year, mid-last year, there were a lot of opportunities between pair trades like GBP and USD with some good pick-up yield in the market. I think that we will continue to see this type of transition. When it comes to the collateral switch that you mentioned, we made more money in corporate than in equity last year. Corporate bonds have been good in terms of yield. I think that will continue.

Opportunities will be more on the corporate side. When it comes to equity, if the volatility continues to be above 20 and up to 25, like we saw at the beginning of the year, there will be opportunity there.

For UCITS funds, you can't go and block those assets. But on the balance sheets of insurance or pension funds they have to deal with a set of regulations that is eating their assets. There is also competition for the same available assets. So if you have a government bond, you need to think:

- are you posting it for clearing under a CCP?
- are you using it for long box for UMR?
- can you make money with it via securities lending?
- or use it for funding to source via the repo?

So clearly, the conversation that we're having with clients is: 'What is the cheapest asset on my balance sheet to use as collateral that has no value? and 'With the assets that have value, how I can make money?' ■

1. SETTING THE SCENE

2. Fails, fines and the way forward

Andrew Dyson, ISLA: There's a lot to talk about and also quite a lot of positives that are coming out of the regulatory agenda. And if I think back to the early days of SFTR and CSDR, many of us, including ISLA, fought hard for certain provisions of that regulation not to come in.

The other thing about CSDR, more recently, is settlement discipline. So, what SFTR taught us about our market is that it's a very big, diverse, broad market. But it suffers from lack of clarity and standardisation.

SFTR was the catalyst of that discussion. More recently, CSDR, a huge piece of legislation, has been much discussed and highly criticised from many quarters, including ourselves, over these two big things: the mandatory buy-in regime, and more specifically, the settlement fail fine regime. After quite a lot of extensive lobbying and work with all of you and several of our friends and other associations, the mandatory buy-in piece was excluded from the go-live of the fines earlier this month. And if you're watching on catchup, that was February 2022. However, the buy-in thing hasn't gone away permanently – just for a bit. I saw something from the European Commission, only this morning before I came down here, which suggests that around about the middle of March, you will see a proposal from them that will include the reincarnation of the mandatory buy-in. There are certain groups who feel that mandatory buy-ins are a good thing, because they engender market discipline.

We don't agree with that view at all because we feel that our market has been quite good at policing itself. The master agreements that many of you know that we sponsor, and cover have this thing called a mini close-out, that effectively allows the same thing.

We need to start working on a dataset with empirical evidence that shows the impact this will have on things like market liquidity. You mentioned corporate bonds: we know that if they start getting mandatory bought in, they will disappear from the market, because clients will just pull them all back and leave them in custody accounts. This cannot be in line with the spirit of this piece of legislation.

Kiely: They tend to be the less liquid parts that we do.

Dyson: Yes, and Vodafone's never failed ever. All the ones that disappear out the door and that you can't get back will be the ones you make most money on, where you've got risk you manage already. These are the ones that will be hit hardest by this regime.

On CSDR, the fines element came in at the beginning of the month. And to answer your earlier question, there is no doubt that heavy fines will change behaviour. We live in a world where we estimate that the fails levels in our market are around about 10%. If you're above that you're not doing as well, if you're below, you're doing better. Since we've been tracking that number, for 18 months, that's gone up, which isn't very encouraging.

What CSDR will do is - there will be some bills looking for a home. And the first incarnation of that cycle will be in about six weeks' time, in mid-March. In the middle of March, you'll begin to see what that means for you and your clients. And I think that could be quite a sobering moment to understand what those fails look like and the magnitude of the numbers. What I think it also really enforces is we must work on things together, that will effectively not change that behaviour but identify the reasons for the underlying fails. It will be increasingly important to bear in mind that if you have a high level of fails in your business, you're going to get absolutely hammered by the regulators.

We know that the UK regulators are looking at a version of CSDR that's not going to be as hard as elsewhere. And we know that they're not keen on doing anything on mandatory buy-ins. However, they all quite like fines. And they will point you to the US Treasury market 10 years ago, they put in huge fines and it miraculously righted itself.

The real killer around fines is around recalls and getting them back early enough from your clients to cover the cash sale on the other side. And the other one is many outward legs fail because the collateral doesn't show up.

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Andrew Dyson

Kiely: On that, I was speaking to my operations department about this last week; we often see borrowers who are returning assets that have not been specifically recalled and the loan hasn't come back, and you just roll it, roll it, roll it, roll it, as the client hasn't asked for it back. They're still getting paid and they're happy enough, but the borrower is going to get fined for this. Anything that speeds up the efficiency of the market is great, but I do think some institutions are going to need almost an army of individuals to reconcile this process. And that concerns me.

Andrew Geggus, BNP Paribas: it's a little bit of the carrot and stick sometimes. But I would prefer to be investing in figuring out how to create better efficiencies as we don't like fails in the market. No one does, it doesn't help anybody. But having to build out a way of dealing with fines coming in and how we implement them, pass them onto clients, where that sits, different account structures as opposed to building out a way of having simultaneous settlement in the future or a network of technology that we can touch on later around settling at the exact same time and removing that risk...

I would prefer to be investing in figuring out how to create better efficiencies as we don't like fails in the market

Andrew Geggus

Dyson: I think they're going to be significant. The other thing I would say is that if you're identified as a firm that is persistently causing fails, you will get a visit from your regulator. Because even if your point is well made about how we should be investing into things that add value to our clients, when you talk to the regulator community, they don't care about that. They just think that a market that has a high level of fails is unacceptable.

Daswani: I would like to remind everyone of something quite interesting. I've always thought that there's no mention of this internally, when CSDR comes up. We still consider Taiwan and Korea like new markets - and Malaysia too to some extent – of some significance that we brought into securities lending.

Yes. And the main point is that you can have a zero fail in that market. And we deal with it, and we lend securities, we make money and we have zero fails. We call them emerging markets, but we are moving somewhat in that direction. Our industry works very well with lending securities and not having fails. I don't see CSDR as a threat, I see it as bringing further efficiency for us all.

Singh: My view is that it's a little bit more than just… I think 10% is a fact but when you look at CSDR, it goes a bit beyond what the end of day outcome is. It's what you do intraday as well that's become more important. You may have STP from a technology standpoint, going front to back, but then you need to start having to cancel some things out afterwards. I think there's an element of process. But there's also an element of actually allocating costs as well. When those fines start coming in, where are they going to sit? We talked about borrowers taking some of them, but this might not be possible. What happens when someone says: we think it's yours. And you say no, it's not. Just as we have all said, it's all actually trying to achieve the right thing. For me, it's more about the amount of time spent resolving something that involves us as agent lenders, and our buy-side clients as well.

Matthew Chessum, Abrdn: From my perspective, I completely echo what Sunil says. We already lend and buy in markets; we already lend in markets where there are fines in place. Anything that involves tightening up processes and making operational flows more efficient, I'm all for. As a beneficial owner, there's nothing more irritating than having failing sales on the back of a securities lending transaction, because a borrower is returning to the wrong SSIs, or something's been dumped in the wrong account, and it's takes too long to resolve. Anything that helps focus the mind to get loans back on time, I think is positive. And like I say, we already lend in many markets where there are automatic buy-ins, and where these penalties do already exist, and we transact in them a lot more efficiently than in those markets where they don't exist.

I don't think that we should be too scared of it. I think the reconciliation is going to be a bit of a nightmare, because from my understanding, a lot of custodians can't distinguish between a securities lending transaction and a normal buy and sell transaction. I can imagine a lot of chasing, going around the houses to find out where the credit or the debit

sits at the end of the day. But I think we're going to have to wait and see, it's going to be a case of waiting until those credits and debits come in, and then seeing where they can be allocated. I think it comes down to buffer management, and ensuring the SSIs are correct first time around.

Martin Aasly, NN IP: I can echo that. We're quite curious to see how this is going pan out, how frequent this is this going be. But certainly, a lot of processes have had to change. It's important to have accurate and timely information flows between the lending parties, custodians, lending agents, it's more important than ever. And our fear going into the CSDR was - and I think this is of systemic importance as well - that we would have to become a lot more cautious about what assets we make available to lend. The logic is that if securities go lower, there will be less liquidity, and the knock-on effect will mean a further reduction in liquidity, which reduces market efficiency. In general, this is just the wrong way to go. And to be fair, I think that's also where monetary buy-ins would have a really big impact. And we're glad that's been put aside. We were hoping indefinitely, but I hear from Andy that's not going to be the case.

Davis: Sunil mentioned trading in Taiwan and Korea, and the mandatory buy-ins and zero fails attached to those markets. The point that was just mentioned about the industry embracing mandatory buy-ins and getting through it needs to be approached with caution. The kind of volumes that we have in the European markets today compared to Taiwan are very different. If mandatory buy-ins do come in across the board then that opens up a whole new agenda. Are we talking a more aggressive style of buffer management in addition to a strain on liquidity? Definitely one to watch as this regulation continues to evolve.

Geggus: This could have a knock-on effect as well for the rest of the industry if borrowers are struggling to get something back. It's not a simple case of, well, they might only be 40% utilised in the market, because if 60% has been held back for buffer management internally, then suddenly that's an active 100% utilisation.

Kiely: Matt [Chessum] - how significant a barrier to entry do you think that is for certain funds? Do you think there's a real danger or a percentage that will just say: 'this is too much hard work; lending is not for me?'

Chessum: Definitely. I think asset pools need now need to be of a certain size to be able to justify the amount of oversight needed to ensure that you're running an efficient securities lending operation. Reputational risk is massive for the buyer side. But, you don't want to be in a position where you're not fully in control of what you're doing, especially in the new world of ESG, and of some of the assets that you're looking to include in the lending programmes.

If mandatory buy-ins do come in across the board then that opens up a whole new agenda.

Nick Davis

Kiely: We saw that when SFTR kicked in, several self-lenders or smaller agent lenders, just said: I'm out, because I do not have the resource for this. Is it right that it's almost pushing the activity towards a smaller number of big players?

Chessum: You've got all this European regulation coming in while UCITS are losing their attractiveness because they're more tied to this regulation. That makes it more difficult.

Kiely: Interestingly, the Bank of England stock lending committee minutes the other day showed that UCITS are going to be lobbied re their restrictions. Because for a long time now, the availability of assets from UCITS funds has been three times the percentage of on-loan assets from UCITS funds.

Dyson: We've tracked the availability of UCITS funds in programmes versus the proportion of on-loan balances. There's 45% of all funds in programmes in Europe, or similar structures, yet they represent somewhere between 15 and 20% of on-loan balances. In a like-for-like standardised world, it should be the same. There's no reason why it shouldn't be. And primarily the reasons UCITS don't lend as much as other people is there's restrictions around collateral and term.

We estimate by looking at the SFTR data that up to 90% of

loans in Europe could come from entities that are outside of Europe. My suspicion is that's a bit high. We did a straw poll three or four years ago, and it came out about 70%. What that means is for all of you lending securities, you're lending on behalf of a client who falls outside the reporting regime on the loan side of the trade.

I was talking to a gentleman who runs a cash equities exchange in the Netherlands. He told me something I was staggered about: 90% of participants are non-European on that cash exchange in Amsterdam. This tells me that, in Europe, there's a lot to do about raising that awareness of what capital markets do. And the reason it's 90% is, we're not in that number anymore. Because think about where most stocks trade: they trade primarily in the London market, because that's where the liquidity is.

Dolce: I think that what we're trying to mention is clearly that the behaviour will change. Where we are making a lot of money is not within UCITS. I'm part of a beneficial owner looking after UCITS funds, and clearly the concern is that they're very difficult to monetise, you cannot go term.

On the collateral side, the liquidity part, I'm not sure you can accept corporate bonds so that keeps you on the equity side, government bonds and cash. To summarise what we said: we will get the constraints from the pledge plus the collateral plus those from the UCITS. I think the UCITS funds will be making less and less money if we continue like that, especially if you're a small asset manager.

We were saying: maybe people will stop doing securities lending. This is quite funny, because three years ago, people were trying to manage in-house securities lending, thinking they would be able to handle it, but SFTR told them no. The good part from my perspective for SFTR and now we can build on it for CSDR is the fact that we can improve our operational setup, middle, back, and automation too.

Singh: Look at the equity market where things weren't electronic front to back. Purely from a securities lending point of view, look at the concentration that's led to in the prime brokerage space. In the US, there are more broker-dealers. If you look at Europe, who are you lending to? There are circa four counterparties. Why do you need an agent to do that? If you're a large asset owner, I think the four sales team should go out and say: we split it into four. I'm kind of saying something that works against me. I worked on the prime brokerage side but I've asked myself that question. And it's quite interesting to see. If you keep going down this path, keep trying to look at the minutiae and trying to cover off the detail…

Kiely: Two words why that won't happen: credit intermediation. ■

2. REGULATION UPDATE

3. Tech: promoting ease of entry into the market

Geggus: The first [area of focus] is obvious, talking about the problems of settlement and CSDR. It's distributed ledge technology [DLT]: there's plenty of test cases where it's used for instantaneous settlement in markets, and there's entrants into the securities lending market that are looking at that.

It's been around for a while, and a lot of people look at it as the crypto platform. But the benefits to it are much beyond that. Within that, we could see the efficiencies that the industry demands and is asking for so if we can get to a stage where CSDR is a memory in the past, because we have efficiency in the market and we're utilising things like DLT, we could really harmonise the market from an efficiency standpoint.

Banks have spent a huge amount of money on technology. Most tech firms end up getting bought by banks so you see investment from banks will not stop. We are becoming larger investors in technology, and we're becoming technology companies in the amount of expenditure that has been spent on it. I think we'll see this develop further, we'll see the benefits from distributed ledger technology for sure. Same thing with smart contracts. When we look at the ability to update a client contract, to update triparty contracts between people – these are ripe for becoming smart contracts. If you move that into a technology-based platform, you remove the need for me to receive a letter, open it, sign it and return it manually back to someone else.

The benefits of that for me are coming. What timeframe? The work that ISLA's doing on things like common domain model to standardise things will help as Andy said earlier. Standardisation is key to that because technology is fantastic, but it has limits on how much it can process for a simple transaction. Because if we need it to do something extremely remarkable, the cost of that for a securities lending agent is too much. So as the technology develops, becomes cheaper, I'm hoping we'll see the industry move towards that further. And then we'll also get the benefits of things like hyper automation, which is where we can change 60% of everything that's been done manually now, to being done automatically via a combination of AI robotics, and everyone's spending money on it.

Dolce: I'm going to be a bit contrarian there. I think that we all get the hype about using the technology more. But I am more with you on the first thought rather than about the 'hyper' part of automation, because it's doing the easier one first.

First, seriously, if we cannot handle an SSI between us on a platform, there is a problem.

I want to use blockchain, DLT. I'm part of a lot of working groups pushing for that. But the challenge that we have is that it's not standardised at all. People are creating their own platforms and there is no interoperability between them. In theory you can increase the efficiency, but you cannot get everyone on board.

If we are talking people - because our business is people, infrastructure, and then solutions. Let's start with the people: you need to train them. I'm not sure that all the middle office will understand blockchain, DLT in all organisations. That means that you need to put the right training in place to make sure that the majority can handle it, not only a select few.

So yes, we need to work on the technology to make progress. But clearly, we still have unresolved issues on simple things like for example, matching SSIs between platforms, having two key players that cannot smoothly communicate on SFTR. We still have legacy issues that we must manage.

Dyson: Andrew [Geggus], you mentioned very kindly some of the work we're doing at ISLA. Nearly two years ago, I recognised that, partly because of the work we're doing with SFTR, the market was quite fragmented. We couldn't change SSIs effectively and SFTR was forcing us to think about it in a different way.

We quickly came to the idea that we need to do two things. The first one was the creation of the common domain model, which essentially, is the codification of industry best practice around trading flows, lifecycle events.

We need to develop and sell products and services based the quality of the service. And you do that by standardising the underlying communications language. And I think this would

In theory you can increase the efficiency, but you cannot get everyone on board.

Ernst Dolce

then facilitate blockchain and multiple platforms. So that version of our market is now freely available through common source for people to use as the basis to start their development. And that should, in theory, deal with the issue about blockchain compatibility, etc.

The other thing we've done is we've started the digitalisation of our master agreements. We've done the clause library: we've now got standard clauses that reflect outcomes, rather than a myriad of clauses that people trade to. And the next thing we will do is bring those into a digital format. It's a step towards smart contracts. Because unless you've got that standardisation, you can't have smart contracts. I think to your point, we've got to walk and then run a bit by doing the basics.

Daswani: I think that the beauty of what you're saying, Andy [Dyson], is that ultimately, what it translates to is ease of entry for others into the space, which is what we all want. I've talked about getting more clients coming in and making it easier for people to lend securities, and again, more transparency, which I think are the advantages that we would see from all of this. And I think we should all support that from that perspective.

Chessum: The question talks about technology changing the dynamics of the market, and we're talking about blockchain and all things quite Star Trek in my mind. There's a couple of things there.

Custodians have to work out how they're going to make money out of having things like blockchain, because it means a lot less processing from their side, which means a lot lower bills from their clients. And beneficial owners are probably a million miles away from anything blockchain unfortunately, at this point in time.

But trying to bring it back to something more topical, or something more real life. Just look at what happened last year, you look at Robin Hood, that was a technological investor platform that sprung up and look at the way that changed our market and the dynamics in our market. I think there's going to be lots of iterations of technological change that are going to have some big impacts on how we lend stocks before we get to a point where we're going to be able to start talking about how we're going to use blockchain for securities lending.

Geggus: I take the point that blockchain is at the moment a bit of a dream for the industry, and also how we can utilise it in its full capacity. But looking at beneficial owners, their long allocations are starting to have cryptocurrency in them, that is a blockchain asset. So, for these, the demand is going to come from the beneficial owners and we as custodians, as well as other market participants are going to need to respond. They will ask how they can mobilise them rather than just being idle assets, can prime brokerages finance them for them? Whilst there is a concept model of utilising the blockchain for the benefit of industry and having some sort of super 'Star Trek' style settlement process, the actual blockchain itself is going to become part of our industry very soon. ■

3. LOOKING AT TECHNOLOGY

4. ESG: securities lending at a 'tipping point'

Dyson: The sustainable agenda is what's going to force our thinking to change over the foreseeable future. I think we will get to a point quite quickly, where we won't be talking about sustainable funds, but those funds that aren't.

Securities lending and ESG: it's a bit of a mixed bag, in many ways. There is a school of thought that suggests that security lending doesn't work as well as it should do in the context of a sustainable agenda. Now, I wouldn't agree with that. But to get our clients where they need to be, I think there's a couple of intersection points that we as an industry are working on.

The first one, of course, is voting. We are in a world of active shareholder engagement and the encouragement of shareholders to play a bigger role in the companies they invest in. Obviously, securities lending is such that if you lend a security, it goes out and typically the vote goes with it.

We've published best practice in that regard to help people understand what they should and shouldn't do, and other areas we're working on because we see that intersection already is collateral. There's a big debate as to the role of collateral from an ESG perspective. Some people argue it should be an exact mirror image of the type of securities that are in the fund. I don't see that as either being practical or prudent because the danger is if you just have back what you've lent, in a different guise. You're increasing your risk in your collateral pool. We shouldn't forget that collateral is there not for fitness or ESG purposes, it's there to mitigate loss if there's an event.

We're beginning to see what I would call counterparty screening at the highest level. Firms are looking at each other going: we're not going to trade with you because you finance coal stocks. And that will trickle down into our market soon, if not already. Because the already complex dynamics about lending, which include counterparty selection, could be about to get a lot more complicated, because your client might say: I can't lend to that borrower, because we don't like their position on coal stocks. Now, I don't know if you're seeing that already. But if not, that's coming.

Daswani: You just touched on the new terminology of green screening. But what's your views on green washing, from the association point of view?

Dyson: We need to be very mindful. There is a suggestion that you can use the collateral dynamics as part of a green washing strategy. Personally, I'm not buying that one. The market has many techniques that will call out inappropriate activity. The most important one is the short sellers, because they're the people that called Wirecard before anybody else did, and they were pushed back in a box constantly by the regulators. And surprise, surprise, the guys that shorted it were right. We must let them loose on ESG scrutiny as well.

Kiely: And pretty much all the big fail events of the past 10 years have been called out by the short sellers before anyone else, so I think they will start to expose this. But surely there will be a form of equilibrium at some stage. I'm not saying we should do nothing and as an industry, do we want to lead the likes of Ernst and Matt? Do we want to lead you towards ESG solutions, or do we want to be forced there? For me, the biggest issue is collateral, because that's the thorniest thing, the most difficult thing to solve. But there will be an element of self-solving about this, because the greater the bad press or negative opinion for certain assets, the less liquidity there will be in those assets. And the less liquid they are, the less we take as collateral.

Davis: Today beneficial owners continue to introduce restrictive collateral sets and are restricting specific assets due to ESG. As it stands currently, ESG remains a priority within a beneficial owners lending programme.

Aasly: I totally agree. It's been a pressing issue for years with ESG funds. It's ESG first, revenue second. The easiest solu-

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Sunil Daswani

You're going to have sustainability ratings, environmental ratings. But I think that we can all work towards this and I think the industry will coalesce around solutions

Zorawar Singh

tion is just to stop lending. It's just a nuisance. Now with new regulation on top of it, there's even more reasons to me to say this.

The work done with ISLA, and before that GPSL, and having a set of rules that you can stick to is Alpha and Omega. Suddenly you can say: look, I'm following the best practice and it has taken these things into account, it might maybe at some stage get some sort of green label on it. All of a sudden, you can prove that you're doing the right thing. That's really the key. And if your agent lender also supports all these initiatives, you can start moving on and regain a lot of those funds that that you lost in the ESG battle.

Chessum: From a securities lending perspective, ESG is no different to any other lending mandate, it needs to follow the investment strategy of the fund, no matter what that is. ESG is just another iteration of that. You have to adhere to the spirit of the actual investment mandate, because otherwise, you're not doing what your investors are paying for. And ESG is just that in a slightly different guise, there is a great deal of reputational risk around greenwashing however and you have to be very careful in terms of the operations that you're carrying out on behalf of your underlying investors.

Kiely: I've had RFPs recently and a couple of clients asked me if they can recall everything when there's a vote. Now, if you're earning a significant return for your pensioners, your investors through lending an asset, is it worth jeopardising that just to ratify something benign at an AGM? I don't think so. But if there's something contentious being voted on, then obviously, you should be doing the right thing. I think it means there needs to be a lot more nuance around these events.

Singh: If you're a beneficial owner, and you're going to take a position on a given day, I think you'd be tracking that well before your agent lender should be calling it back. I don't think you can outsource that activity.

You're [Andrew Dyson/Isla] leading the charge on this by a country mile, if I may say so.

As a result, we're sitting here today at an EU roundtable, I think we have to be cognizant of that. It is still, however, a global industry.

To your point about transition, I think there has to be some bridge to that. I think there's going to be such standardisation in the collateral market. I mean, triparty is going to play a major role, rating agencies will come up just like we've heard for credit rating, you're going to have sustainability ratings, environmental ratings. But I think that we can all work towards this and I think the industry will coalesce around solutions. I think it's the kind of front end which we are talking about the voting, that stuff is a little bit more unique to each underlying beneficial owner.

Dyson: I've talked to regulators about this. They need to think about what they want this market to look like. Because if you want this market to be deeply liquid and attractive to retail investors, you've got to encourage people to participate in things like securities lending, to provide that liquidity that underpins the markets. And at the moment, they're remaining sort of silent on many issues. But the simple fact is that we need ESG funds to be lending to create the liquidity that people need to see.

In terms of voting and the comment about recalling, I think it says in our best practice: we wouldn't necessarily say that you need to do that all the time, because you don't. Each client needs to figure out what are their dynamics and then work with you, their provider to come up with a solution that works for them.

Dolce: I think education has a part to play here. For example, where we onboard funds, the way that we look at it is like we give the analysis without any ESG filter. We say: this is the maximum revenue, based on the current market conditions that you can realise.

Now, let introduce the possibility to recall all assets in order to exercise the voting right of the funds, this is the new level of return that could be generated. Let's add ESG constraints on the collateral now, this is the new level of return that could be generated.

And after that we have an open conversation with the clients, asking them what they want. It's very clear that you will have clients that will want to exercise their voting (on systematic basis or on discretionary basis). My personal opinion is you need to allow the clients to vote, it's a no-brainer. On

the collateral part, I agree with you Andrew [Dyson] that it's there to protect the fund and should not have this type of high correlation with all the assets available in the funds.

Kiely: We're responsible for the education here because there are still too many participants that see securities lending as some form of asset swap. You can't say: I'm lending stock in an electronic carmaker and I'm taking stock in a coal fired power station as collateral, and therefore, that's a bad thing to do.

The work done with ISLA, and before that GPSL, and having a set of rules that you can stick to is Alpha and Omega

Martin Aasly

Daswani: I read many ESG papers before coming to this. And there was one sentence which summarised everything quite nicely. I read it in an RMA paper about securities lending programmes. It said that these programmes should not be viewed as ESG compliant, but they should allow investors to achieve their sustainability objectives. I think that summarises how we should be operating our securities lending programmes. We're not trying to make our programmes compliant, we will work with clients to fit in what their objectives are into our plans. That summarises for me very beautifully how ESG should fit in, in the securities finance world.

Chessum: I agree. How many asset owners lend in emerging markets and how many asset owners lend government bonds and get corporate bonds back or in emerging markets, they take main index developed market equities as collateral back. Lending on ESG funds is no different. You wouldn't take like-for-like, necessarily, but I do think it's important to give it some extra consideration in terms of the types of assets that you are going to be receiving just in case, any of your underlying investors did want to have a look through as to how their fund was transacting. And they should be aware that if you are taking on non ESG assets as collateral that that is taking place.

I think that's where the legislation will probably end up. There'll have to be some sort of language in prospectuses outlining for article eight and nine funds, how they collateralise their assets or any lending transactions. ■

4. THE ESG THEMATIC

5. Final thoughts

Davis: I think the theme has definitely been around efficiency. I have to agree around tokenisation when it comes to settlement efficiency. I think Andy [Dyson] touched on it earlier from a CSDR perspective: when you have loans which haven't settled due to pending collateral, tokenisation eliminates that due to instantaneous movement, even if the CSD is closed. We discussed financing and the continued support to beneficial owners who are long or short cash. Peer to peer will continue, and although well-established, there remains continued growth for non-standard borrowers. Finally from a beneficial owner perspective, the focus has to be around APIs. Efficient reporting allows clients to review their program's analytics real time without waiting for emails to come through, and therefore has to be a focus for 2022 and beyond. These were my key points.

Geggus: For this year. Nick [Davis] mentioned efficiency, but I think this is the year where it's actually used to determine who you want to trade with. We've always had difficulties with trading certain counterparts. And that's been used as a way of saying: you need to improve here, we're noticing you're failing more than others.

The second one is cash solutions. We spoke about it earlier, we have become a securities finance industry. And I think that once again, you're seeing these news reports regularly about different banks, and some of the peers here, coming up with solutions for clients that are long cash, and also clients looking to raise cash.

And then lastly, it's real-time data. We spent a lot of time in the last two years implementing data depositories to the regulators for SFTR. And I think that the firms need to mobilise that more and be able to use real-time data for clients, and to use real-time data to manage programs, as opposed to waiting for systems to download things overnight.

Kiely: I said earlier that over the next couple of years, lending digital assets and the tokenisation of collateral will be very important. But I think that's a few years away. For the next 12 months, it's looking at greater access to the retail space. I think in the next 12 months getting the retail investor access to this market will be hugely important and it will have a have a big impact. Lastly, I'd like to see this year be the end of the phrase, 'I'm sorry, I was on mute'.

Dolce: From my perspective, it's finding a liquidity solution, and to leverage on what Sunil said at the beginning, it's more moving from an Alpha contribution to optimisation. We are good at doing that but implement such approach for all our clients will depend on their profile.

When it comes to APIs – I can't find a better word for that. We use industrialisation internally, but I think API is the best. Clearly if we want to have something more efficient, we need to be able to plug and play, and currently we are not a plug and play industry.

The final part would be a more robust operating model. We think about the client, the trading part, and we forget that the middle office and the back office are still struggling. We need a more robust operational framework as an industry.

Chessum: I think this year is really going to be the year of the beneficial owner!

Given what we were saying before, there's a lot more interaction between beneficial owners now: they have to be more advanced in their way of thinking and be more involved in what's actually happening in lending programmes. It's good for the market and it's good for them. And I think it makes it a more dynamic place.

I think ESG is going to continue to dominate absolutely everything that we do. Where we're talking about blockchain and tokenisation, that may be a potential solution, especially when you look at its use for ledger technology and voting, and to some of the problems that we face. I think that the fact that we're beginning to think about it, is definitely positive. I think we're all just going to be ESG'ed out by the end of the year.

Aasly: First of all, I really hope Matthew is right. On the beneficial owner part, I do think that there is there is an increase in involvement. And on our part, a lot of our focus will be on collateral optimisation still, in an effort to utilise our clients assets optimally, in the face of mounting collateral requirements and UMR.

And secondly, on sustainability and ESG, we've been grappling with that for years. I think that we're practically there. We still need to educate clients, talk to them, ping pong ideas: no client is the same. I am not talking about the fund clients, but insurance and pension funds. You really need to be able to tailor this to their needs and to how rigorous they are on the ESG approach. A lot of effort is still going to be going towards that.

Daswani: I would say that from my perspective of Standard Chartered and looking at the client base that we focus on, which is central banks and sovereign wealth funds, that the new liquidity solutions that we've spoken about today are very much what is in demand in that segment, and that client base, and I do see that continuing to grow further out with people using securities finance solutions.

The second thing I'd probably say is that I hope that we can see more ease of entry. And this ties back with what we've

said around retail and private investors also entering into the market, and creating a kind of Airbnb for securities finance.

And lastly, what I would like to see looking forward. I look to Andrew [Dyson] on my left, and we haven't mentioned it, but the work that the industry associations have done on how we can unify and harmonise a lot more. We sit here as an EU roundtable, but we repeatedly as global players in this field are having to deal with the same issues multiple times. And that is very costly in an environment where we're trying to be more efficient.

Dyson: I think there will be a greater involvement of the beneficial owner community in the next weeks, months and years. I think that's driven by the sustainable agenda. Perhaps in the past, some people have taken beneficial owners for granted in programmes.

And the final thing I would say: by this time next year, we'll be talking about something quite different, which is digital regulatory reporting. And what we're beginning to see from the regulators is: under the previous model of SFTR, they tell you a template and you create some stuff and you send it to them. And that's just purgatory when we want to know how that is. The way this is going quite quickly now is they're going to operate a pull model, or effectively identify the data points they want from you and your systems, and they will deliver that code to you, which you will then put into your systems and then it just extracts the information. That only works if we've got standards. Luckily, we've got some of those.

Singh: For me, customisation is the key. We don't like to say that, but I think it's very much what our clients need. We've talked about solutioning. I think clients want different things, and more importantly, different clients want different things, whether it's ESG, whether it's what they're trying to get done in terms of revenue, or liquidity.

So to me, in 22/23, all the technology trends are obviously there to stay. We have already talked about APIs and I think licence to operate is my core baseline. We've got to stay relevant, be compliant, efficient, I think that goes without saying. But while doing that, how do we do solutions? How do we focus on different clients, different needs, provide that customisation in a market that's quite concentrated at the top end, and then kind of bifurcates out pretty quickly?

Dyson: I am listening very carefully to what you guys said. Nearly every one of you said one word: efficiency. That's what I'm hearing from everybody, so it's quite telling. ■

Nearly every one of you said one word: efficiency. That's what I'm hearing from everybody, so it's quite telling

Andrew Dyson

5. FINAL THOUGHTS