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Canada weathers the storm

RBC I&TS' Don D'Eramo and Kyle Kolasingh discuss the effects of the pandemic, ESG and automation on the Canadian securities finance market

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ISLA adds securities finance code to CDM

The International Securities Lending Association (ISLA) has contributed code to the core Common Domain Model (CDM) database — a single digital representation of securities trade events and life cycles.

The contribution marks the first time components of a non-derivative product have been contributed to the CDM, and is an “important milestone”, ISLA said, in the ongoing development of a truly cross-product model for the benefit of the financial services industry.

A CDM encodes a transaction and the events that occur to that transaction “explicitly and unambiguously”, so that common inputs lead to common outputs throughout the lifecycle of a transaction, ISLA says. Ultimately, a CDM would encode the entirety of a transaction from onboarding, contract negotiation, execution, processing and ultimately termination.

ISLA’s contribution allows the recording of securities loan product and transaction definitions, as well as a settlement and allocation event for cash settled ‘delivery versus payment’ loan.

The new code, completed at the end of last year and piloted by fintech firm REGnosys, will build on the CDM first launched by the International Swaps and Derivatives Association (ISDA) as a blueprint for how derivatives are traded and managed.

ISLA CEO Andrew Dyson says: “I am absolutely delighted that we are now able to begin the process of sharing the power of the CDM with our wider community. The addition of our pilot work from last year within the core CDM is a clear statement of intent from ISLA and our friends at ISDA.

“As we progressively develop the combined open source cross product CDM, market participants will start to see the benefits of this important investment that will set the backdrop for the future state of our markets.”

ISDA chief executive Scott O’Malia comments: “Having securities lending products and events added to the CDM is an important step in our shared ambition to create a single set of machine-readable standards that can be used across asset classes. This will ultimately increase efficiencies for market participants, reduce costs and enable greater levels of automation.”

Inside this issue

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Sharegain launches BetterLend

Sharegain has launched BetterLend, a platform that supports social and environmental causes through securities lending activity. BetterLend allows Sharegain's clients to use their lending activity to create positive change across four areas: clean water, reforestation, renewable energy and education.

When Sharegain clients opt into BetterLend, they choose a percentage of lending revenue they want to commit and the initiatives they want to support. Clients choose one or more of the above areas to put their lending revenue towards.

BetterLend then handles the implementation, by partnering with charitable organisations that align with those areas and identifying projects that will be delivered through clients' lending activities.

Sharegain CEO Boaz Yaari says: "For the first time, a securities lending agent is taking a stand, not just by supporting principles of sustainable finance, but ensuring securities lending revenue is doing good in our world.

"Until now, securities lending has dealt with governance — the 'G' of ESG, ensuring securities lending is ESG-compliant. Now is the time to make it truly compatible.

"Many investors want to achieve more with their securities lending. They want to deliver on the 'E' and the 'S' of ESG. We are very proud to launch BetterLend, making sure securities lending is ESG-compliant, while enabling our clients to make a positive impact in the world by planting trees, digging wells and installing solar panels, all by lending their securities."

Pirum builds out CollateralConnect

Pirum expands its CollateralConnect platform with enhanced risk management capabilities.

The new module — Exposure Analytics — improves visibility, workflow and controls to help firms improve monitoring risk within their bilateral, triparty and collateral management programmes.

The collateral management service's new module allows for real-time monitoring, which helps firms to comply with regulatory requirements, such as the Markets in Financial Instruments Directive, the Basel Committee on Banking Supervision and Basel.

Exposure Analytics also has baked in compliance controls, thanks to independent compliance checks mandated by regulators, Pirum says.

Pirum's head of innovation Todd Crowther says: "Clients have been asking us for an independent overview of their exposure risk as well as analytics to understand, validate and manage their collateralised exposures with counterparts.

"Our new tool brings together the benefits of our real-time collateral management functionality with our advanced analytic tools, helping firms monitor and stay on top of both their day-to-day exposure risks and their compliance obligations."

Last month, Pirum built out the CollateralConnect service to give clients the ability to manage all their bilateral secured financing activity, in addition to their triparty trades in a single platform.

The bilateral trading functionality enables clients to manage securities lending, repo and derivatives margin relationships across multiple collateral venues globally.

Cardano Risk Management teams up with deltaconX

deltaconX's regulatory platform has been selected by Cardano Risk Management to provide its clients regulatory reporting services under the European Market Infrastructure Regulation EU and UK.

Cardano Risk Management is offering its risk management and execution services to more than 50 European and UK-based pension funds, through its entities in the Netherlands and the UK.

In addition to this new service offered to their clients, Cardano Risk Management, as an investment firm, also has its own transaction reporting obligations under the Markets in Financial Instruments Regulation, which they will fulfil via the deltaconX regulatory platform.

"Following several statements from the regulators highlighting that market participants need to ensure a better quality of the reporting data and a better control over these data, we believe that this new initiative of Cardano absolutely makes sense and will help to achieve both requirements formulated by the regulators," explains Fabian Klar, director of sales and customer relations at deltaconX.

Klar notes: "Joining forces, as we do with Cardano, is in our opinion the right way

in the future to serve clients' needs in an increasingly complex and regulated environment in which at the same time cost pressure becomes increasingly important and challenging. We are looking forward to fruitful cooperation with Cardano and to further extend it in the future."

Marc Strijbos, head of legal, risk and compliance at Cardano, says: "deltaconX convinced us with their state-of-the-art regulatory platform including a wide range of value adding functionalities, their flexibility, and their regulatory expertise."

"We are convinced that deltaconX is the right partner for Cardano to support us and our clients in fulfilling our regulatory reporting requirements in the most efficient way," adds Strijbos.

New German green bond eligible in Eurex Repo's markets

Germany's federal government issued a €6 billion 30-year green bond for the first time on 13 May, as part of its strategy to give investors worldwide access to green benchmark bonds.

The new bond will be eligible in Eurex Repo's markets, including in the Green Bond GC Basket, as well as eligible for margin collateral at Eurex Clearing.

Eurex Repo managing director Frank Gast says: "We are delighted to be able to assist the German federal government in further establishing its green yield curve, and we congratulate the German Finance Agency and the involved banks for this successful transaction.

"Established [in November] last year, our Green Bond GC Basket was designed to meet demand from both buy- and sell-side clients with strong ESG mandates and has really kicked off the discussion regarding ESG in the repo market."

The Green Bond GC Basket encompasses euro-denominated fixed income securities that are issued in adherence with certain guidelines, including renewable energy, preservation of biodiversity and sustainable waste management.

Germany's 'green' federal securities are part of the federal government's sustainable finance strategy, designed to help the country meet its ambitious climate targets.

German Finance Agency executive board member Tammo Diemer says: "With the new 30-year green federal bond we are now offering the longest-dated green bond of a sovereign issuer in the euro capital market and are already completing the long end of the curve — just a few months after entering the green segment — with a maturity in 2050.

"We are very motivated to continue with this concept and thus further contribute to the development of the sustainable financial market."

The placement of the green bond with national and international investors was carried out by a syndicate of banks under the lead management of BNP Paribas, BofA Securities, Citi, Commerzbank, DZ BANK and HSBC.

Germany's new Green Bond follows the International Capital Market Association's European Repo and Collateral Council (ERCC) consultation paper on how a future repo market can fit into green and sustainable finance. The consultation was launched last month and is open until 28 May.

The paper highlights that one of the largest obstacles in green bond trading has historically been the lack of secondary market liquidity. The ERCC envisions a green repo market where buyers and sellers would only transfer bonds that are classified as green, such as the Green Bond GC Basket launched by Eurex, which acts as a short-term funding vehicle for green assets.

Frontclear concludes first Dominican Republic cross-border repo trade

Frontclear has completed Dominican Republic's first ever GMRA-documented cross-border repo trade.

The $20 million repo trade — documented under the International Capital Market Association's Global Master Repurchase Agreement (GMRA) — between Parallax Valores, a Dominican securities firm, and investment banking company Credit Suisse used locally issued Dominican Republic government bond collateral.

The repo transaction was documented under a standard GMRA 2011 and intermediated by Frontclear subsidiary FCC Securities, which established local custody infrastructure in order to secure title transfer of the collateral.

The successful conclusion of the trade demonstrates the benefits of using international documentation, the importance of clarity around title transfer of collateral and enforceability of GMRA provisions in a close-out scenario.

Frontclear's investors are largely government-backed institutions that invest in private sector projects in low and middle income countries to promote job creation and sustainable economic growth, and contribute to sustainable development.

Frontclear vice president Daniel Baeza says: "We are proud to have structured a first-of-its-kind cross-border repo transaction using locally issued government bonds as collateral.

"This trade will undoubtedly pave the way for Dominican financial institutions to access long-term offshore funding using existing local [government bonds] that otherwise do not allow for longer tenure stable funding. We believe that this trade sets a benchmark for the development of the Dominican Republic's money market going forward."

Parval treasury director Pedro Vázquez says: "We are confident that this will have an extremely positive impact in the Dominican market, with this transaction being only the beginning. We look forward to continuing to work with our clients and counterparties in developing a cross-border financing market."

Citi launches automated securities lending solution for private investors

Citi has partnered with fintech firm Sharegain to launch a custody services-facing securities lending solution.

Designed for the global wealth management firms that Citi caters to, the solution is designed to integrate with existing IT infrastructure and provides a fully digital user experience, providing the information and controls needed to manage portfolios.

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Pirum's SFTR solution enables new counterpart communication function

Pirum's Securities Financing Transactions Regulation solution now has intra-team and cross-counterparty trade comment functionality.

Working with IHS Markit, the new enhancement service workflow means users can communicate with their team and counterparts in one place, helping to mitigate pairing and break issues between parties.

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SEC needs to plug short selling data gap, says commissioner

US Securities and Exchange Commission commissioner Caroline Crenshaw has questioned whether in the wake of GameStop, the regulator has sufficient information regarding short selling and the securities lending market.

"Without information about the markets that the SEC regulates, we may fail to address problems in our markets, or even make them worse," Crenshaw explains.

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Siebert securities finance division hits record revenues

Financial services provider Siebert's Securities Finance Group achieved its highest ever quarterly revenue, with its Q1 2021 total standing at $1.8 million.

The firm attributes the record revenues to investments in personnel and key areas of the business, helping to offset lower interest rates. The brokerage firm also saw its total revenues increase in Q1 2021.

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Associations publish SFTR statement updating collateral provisions post-Brexit

Various industry associations have published a joint statement designed to inform market participants of the general risks and consequences that may be involved in consenting to a right of use of collateral post-Brexit in relation to SFTR.

The statement was prepared by the ISLA, AFME, FIA, ICMA, and ISDA.

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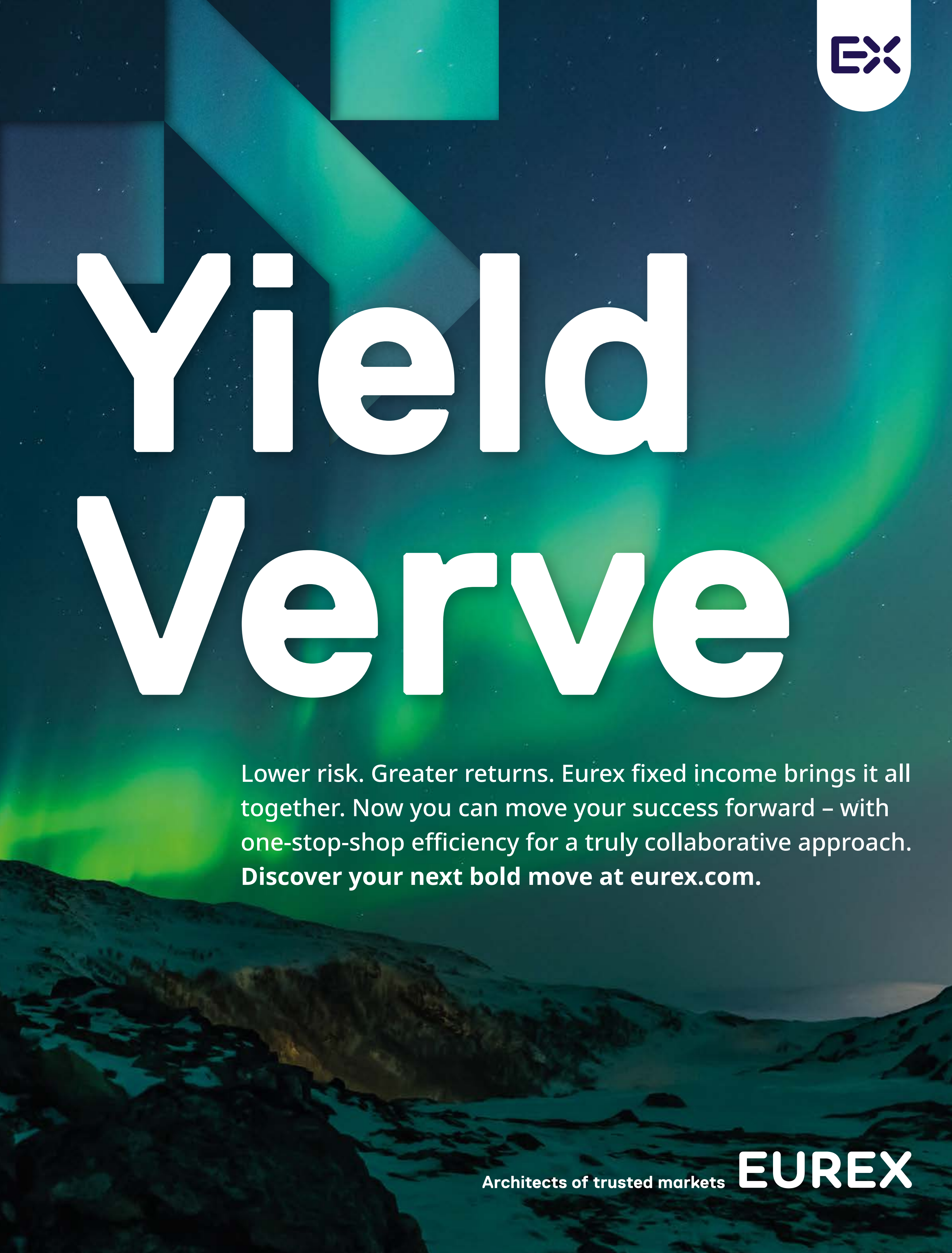
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Canada weathers the storm

RBC I&TS' Don D'Eramo and Kyle Kolasingh discuss the impact of the pandemic on Canadian securities finance and the ongoing role ESG, ETFs, data and automation are playing in the industry

Kyle Kolasingh
Associate director of securities finance
RBC Investor & Treasury Services

Don D'Eramo
Managing director, securities finance
RBC Investor & Treasury Services

Where do you think Canada's market fits into the picture globally for ESG-focused investments?

Kyle Kolasingh: The increased focus on environmental, social, and governance (ESG) in Canada is generally consistent with the rest of the world as we continue to see more ESG funds launched by local providers. ESG has been embedded in the corporate citizenship activities of major Canadian corporations and institutions for a number of years. For example, RBC's corporate social responsibility mandate and environmental initiatives have existed for well over a decade. Actions that support ESG activities are an enduring fixture of the securities finance market, including the ability to vote proxies—a longstanding securities lending practice available through loan recalls. However, we have recently been engaging in more integrated ESG conversations with beneficial owners, extending beyond governance to align lending programmes with broader ESG goals and integrating such factors into their investment strategies and lending activity.

Don D'Eramo: The Canadian securities lending market also aligns with global initiatives to standardise ESG principles. RBC Investor & Treasury Services (RBC I&TS) continues to work closely with two groups that are leading ESG discussions for securities lending, The Global Principles of Sustainable Securities Lending and the International Securities Lending Association. These international groups have been instrumental in raising awareness of the alignment between ESG and securities lending, helping to reinforce the message that ESG and securities lending can co-exist.

Do you think that Canadian beneficial owners have a different view of ESG than their peers in the US and EU?

D'Eramo: Broadly speaking, the views of beneficial owners on ESG are similar across geographies. However, opinions may vary on a case-by-case basis where lenders have incorporated different ESG applications within their investment strategies. As Kyle mentioned, up until recently, the ESG focus was on governance. However, beneficial owners are beginning to develop a broader understanding of ESG. This includes a discussion of how securities lending promotes liquidity, price discovery and transparency across global capital markets, contributing to the efficient operation of these markets.

Let's move on to another initialism — ETFs. Canada has a number of progressive ETFs, including Bitcoin and cannabis. How do you think they will impact securities lending in Canada, compared to other countries that don't have those types of ETFs?

Kolasingh: Historically, ETFs have been a popular segment of the securities lending market but demand for ETFs—in Canada and globally—has grown significantly over the past year primarily due to increased liquidity and hedging requirements. Given the suppression in specials over the past 12 months, ETFs are currently a significant revenue driver for beneficial owners across equity and fixed income classes. We anticipate that the recent introduction of cryptocurrency ETFs in Canada will open new opportunities for beneficial owners and borrowers.

When it comes to ETFs, Canada is really no different than the US or Europe. We tend to align with Europe on many facets of securities lending, including ETF penetration. In terms of liquidity, Canada lags the US due to the sheer size of the market but as progressive ETFs continue to evolve and more of these funds launch within Canada, we expect to see a positive impact on the securities lending market.

How are the effects of the pandemic different from the financial crisis of 2008 in relation to the Canadian securities lending market?

D'Eramo: A calmer approach seems to have prevailed during the pandemic compared to the global financial crisis of 2008, which saw many securities lending clients run to the sidelines. This time round, lenders generally maintained an air of focus, conducting comprehensive risk reviews in response to the market shocks caused by COVID-19 and adjusting their securities lending programmes accordingly. I think that beneficial owners generally felt more at ease with the increased transparency of our securities lending programme, and this facilitated an enhanced understanding of their programme and its risk parameters.

The cash reinvestment component was a particular pain point for many lenders during the 2008 global financial crisis globally, but especially in the US where cash collateral was most prevalent. At the height of the pandemic, it was much easier to adopt a changing risk appetite given the predominately non-cash environment in

Canada. The ability to avoid dislocation, particularly around failing transactions, added to the sustainability of the Canadian securities lending market.

In addition, COVID-19 was the catalyst for above-average market volatility, which caused a number of lenders to review certain risk decisions, resulting in a flight-to-quality that provided opportunities for Canadian beneficial owners. The securities lending business has generally proved to be significantly more resilient than 20 years ago and this is very much a testament to the growing maturity of the industry.

How do you see automation and data playing out at RBC in terms of securities lending?

D'Eramo: RBC I&TS is a Canadian market leader in securities lending automation. From an execution perspective, we optimise clients' lending programmes through a high degree of market connectivity and by leveraging various Fintech platforms. We also continue to digitalise our client experience, including the development of robust client dashboards that enable beneficial owners to access the necessary data and make results-driven decisions. This is particularly important as markets become increasingly complex, the regulatory landscape continues to evolve and beneficial owners introduce more sophisticated financing strategies that extend beyond traditional agency lending.

Kolasingh: Access to data, whether in the form of interactive visualisations or via automated delivery channels, is key to helping clients achieve their securities lending goals and overall investment strategy. For example, one of the noticeable trends during the onset of the pandemic was beneficial owners' use of structured derivatives within their investments. Readily understanding the dynamics of one's securities lending portfolio through enhanced access data enables such timely and informed decision-making. This connectivity requirement will continue to drive our digitalisation strategy.

We also leverage data internally, tapping into our custody platform to identify lending opportunities for beneficial owners who are not part of the agency lending programme. Historically, a number of such beneficial owners, particularly non-institutional investors, have been under the impression that they are unable to participate in securities lending. This is not necessarily the case. A single name within a portfolio may actually derive comparatively larger revenues than a much larger portfolio because of that one name. Our data mining capabilities have enabled beneficial owners to realise such latent opportunities quickly, often within two to five days from data discovery to execution.

What do you think is going to drive revenue in 2021 as we near the tail end of the pandemic?

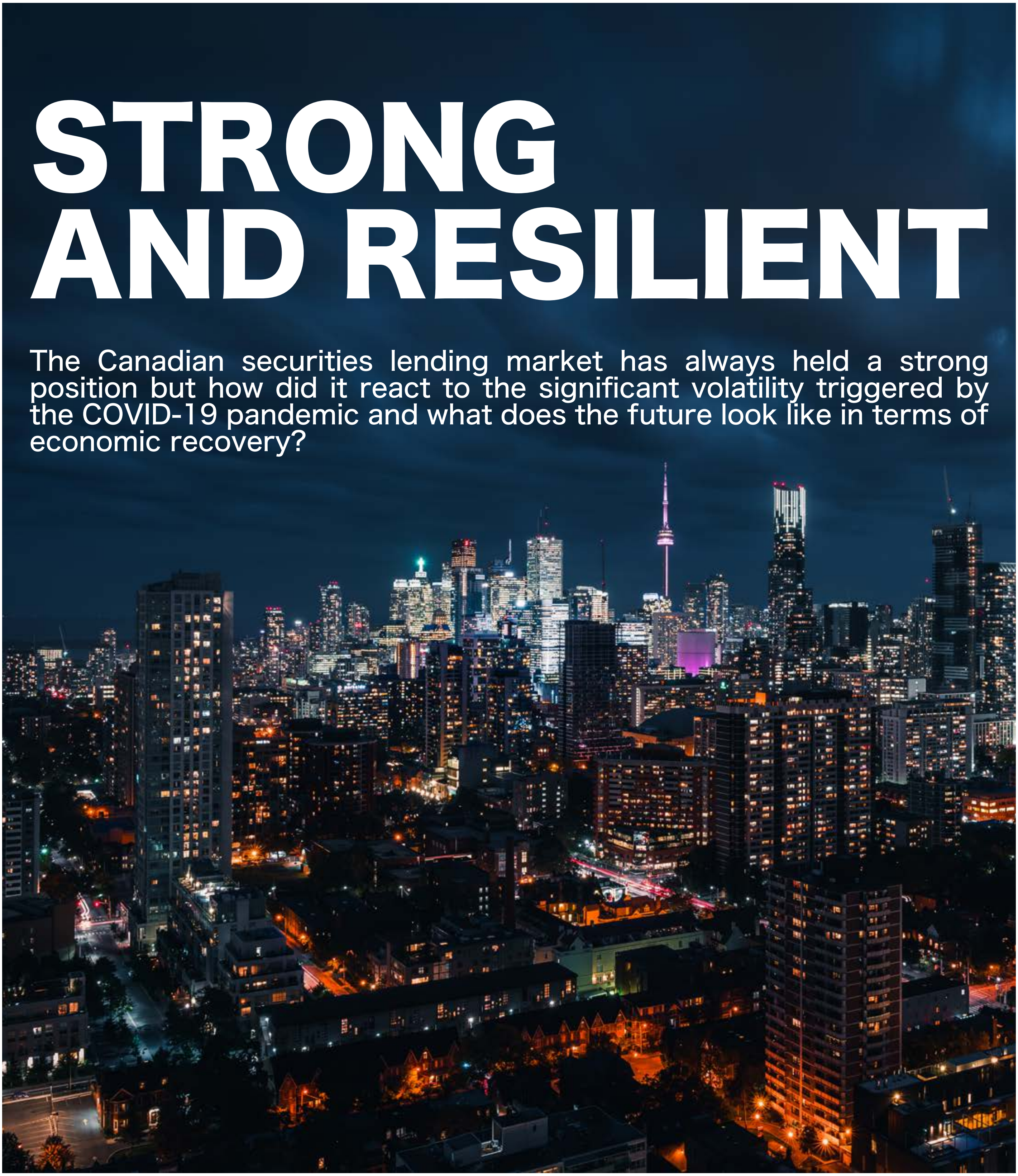
Kolasingh: Securities lending revenue profiles have undergone significant change over the past year, especially within the Canadian market. Looking back, legalisation of the cannabis industry was driving much of the revenue in 2018 through to early 2020, providing a number of opportunities for beneficial owners. Coming out of 2020, Canada and the global market experienced a notable suppression in hard-to-borrow securities, a dip in special fees and a tapering of overall demand. This was partially due to a lack of demand as hedge funds closed directional positions and deleveraged, thereby reducing the need to borrow. On a positive note, there are promising signs south of the border where hedge fund assets have increased over the past year, particularly during the previous six months. This is an encouraging indicator for the securities finance industry and we hope to see a resultant increase in demand.

We also witnessed lucrative event-driven opportunities, including initial public offerings (IPOs) and corporate actions, and believe that these types of opportunities will continue throughout 2021. IPOs have historically created opportunities for beneficial owners, and the recent uptick in upcoming Canadian IPO activity bodes well for the industry. In April, we experienced higher activity in the cannabis industry, largely driven by increased mergers and acquisitions. As market improvements materialise, we expect specials to come back to the market and we are closely monitoring the situation.

On the fixed-income side, the demand to borrow high-quality liquid assets (HQLA) on an overnight basis has remained fairly stable over the past 18 months. In 2020, we encountered a suppression in demand for structured term lending opportunities on HQLA but some of this activity has returned. As markets continue to improve and stabilise, we expect these types of opportunities to drive revenue for the remainder of 2021 and into next year.

STRONG AND RESILIENT

The Canadian securities lending market has always held a strong position but how did it react to the significant volatility triggered by the COVID-19 pandemic and what does the future look like in terms of economic recovery?



Canadian pension funds closed 2020 in the black, according to Industry Benchmarks, but how did lenders get on in 2020 and where are they at now?

Lisa Tomada: Even with strong management and a global reputation for resilient performance, Canada's pension plans are not immune to shocks in the markets in which they operate. The COVID-19 pandemic has been testing pension plans and their asset managers, prompting significant volatility in financial markets and reshaping the global economy. The good news is that Canada's pension plans are well-governed, maintaining diversified portfolios that deliver returns closely aligned to their long-term liabilities. This far-sighted approach has provided some protection from the disruption caused by COVID-19; most plans have the time and the space they need to work through the immediate impacts of the pandemic on short-term returns.

Canada's pension plans have a long history of leadership in alternative and private investment and with incorporating responsible investment strategies and environmental, social and governance factors — with a progressively prominent role in the global investment community — and their style is increasingly recognised globally as 'the Canadian model'. Canadian plans have a stronger focus on direct and co-investment strategies than most other institutions. Canadian institutions are already among the world's most admired and influential and they appear set to retain that status in the years to come.

An important aspect that distinguishes Canadian investors from others in the pension space is a strong capacity for innovation and dexterity. In this environment, pension plan leaders are now thinking hard about what is needed to maintain confidence in their ability to meet their long-term obligations – above all, to fund pension payments to their members.

Jack Herron: Canadian equity lending demand has increased over

the past few years. Borrowers from the US, Canada, and abroad have increased demand to borrow Canadian securities from large holders which include Canadian pensions.

Additionally, it appears the ongoing transition from cash collateral to non-cash collateral from Canadian borrowers is continuing. This has resulted in increased usage of triparty collateral platforms as a method of transacting versus keeping the transactions in the bi-lateral space. Increased usage of triparty, particularly as Phases five and six of the Uncleared Margin Rules (UMR) progress and Liquidity Coverage Ratio/ Net Stable Funding Ratio becomes more prevalent in Canada, seems to be a trend that will continue into 2022.

George Trapp: 2020 was a year where clients, including Canadian pension funds, saw positive returns from a variety of factors. The year started out with a relatively strong demand for securities lending. However, as the COVID-19 pandemic kicked off market volatility, this led to clients repositioning their portfolios, which triggered an influx of sales and a demand for high quality liquid assets (HQLA) in the form of Canadian Government bonds and US Treasuries. The securities lending business proved its resilience and was able to meet the demand. Governments and Central Banks around the world stepped in to pledge unprecedented levels of economic support.

The primary areas of revenue in 2020 for Northern Trust's Canadian lending clients have centred around 'in-demand' single name equities, exchange-traded funds (ETFs), special purpose acquisition companies (SPACs), and dividend reinvestment plans (DRIPs). Specials were centred in sectors affected by COVID-19 including airlines, travel and tourism, energy and industrials which continued to experience an increase in demand, and in many cases at increased lending spreads. In the fixed-income space, there was continuous demand around the Canadian government bond benchmark issues as well as HQLA collateral upgrade trades for open and term structures.

"The vast majority of liquidity was generated by way of the term repo facility which was the most active and longest standing"

Mary Jane Schuessler
Director, equity finance, global equity products group
BMO Capital Markets

We expect that securities lending in 2021 will continue to be a consistent source of alpha for pension funds. Currently, overall demand remains strong for securities lending in Canada with utilisation up slightly with fixed income balances accounting for most of that increase.

Chelsea Grossman: State Street's overall experience with the 2020 Canadian lending market aligned with the main themes seen across the industry, where an increased lendable supply along with a general lack of "specials," or hard-to-borrow stock, resulted in a challenging earnings environment for Canadian lenders. In Canada specifically, cannabis stocks were at the forefront of Canadian equity revenues since its legalisation in 2018; however, beginning in Q3 2020, the market saw declining demand for those positions and a corresponding negative period-over-period earnings impact to those lenders who held them. With no material replacements in terms of specials in Canada, this shift in market demand certainly added to the revenue challenges for the remainder of 2020.

That being said, there were pockets of heightened borrower interest in specific asset classes and sectors seen throughout the year where lending clients, particularly those asset owners with guidelines allowing for expansive collateral acceptance, were able to capitalise on certain opportunities. For instance, lenders with large, stable ETF or government fixed-income positions, as well as those with holdings in pandemic-affected companies and Canadian DRIPs, saw healthy utilisations in those securities throughout the past year that continued to generate returns across their programmes.

As we progress into Q2 2021, the continued environment of depressed specials has placed even more of an emphasis on lender flexibility; however, the core book of balances outside of hard-to-borrow stock has continued to provide clients with a consistent revenue stream. State Street's Canadian clients overall saw a 24 per cent increase in earnings between Q4 2020 and Q1 2021, with asset owner clients experiencing a 19 per cent increase.

Kyle Kolasingh: Canadian defined benefit pension plans ended the year in positive territory against a backdrop of ongoing uncertainty. According to the RBC Investor & Treasury Services (RBC I&TS) All Plan Universe, Canadian defined benefit pension assets returned 9.2 per cent overall in 2020. Canadian pension plans continue to see benefits of the low-risk incremental returns derived from securities lending programmes, even during challenging times such as 2020. With significant positions in level one sovereign debt, which remained relatively attractive throughout the year, Canadian pensions earned stable lending fees throughout 2020, especially where collateral flexibility permitted term lending.

While the market for deep specials was suppressed, pockets of intrinsic value presented significant revenue opportunities for eligible holders, particularly in the second half of the year. Most notable was the persistent demand and elevated fees for Brookfield Property Partners (BPY-U). Fast-forward to today and Canadian pensions continue to reap the benefits of securities lending, but not only from traditional lending. As pension funds grow and seek more sophisticated leveraged strategies to increase returns for their beneficiaries, many look to their agent lenders for assistance with integrated borrowing facilities. At RBC I&TS, not only do we work consultatively with pension plans to drive incremental returns but we also partner with our clients to execute their longer-term investment strategies through bespoke securities financing solutions.

The Canadian central bank was among those that opened new liquidity lines last year. How did Canada's strategy to cope with COVID financial strife, compared to the US or Europe? Are any of those liquidity facilities still available?

Mary Jane Schuessler: Globally, central banks were very quick to intervene after markets experienced liquidity challenges. Despite various nuances across global liquidity programmes, the introduction of several new/unprecedented facilities, including expanded collateral classes and longer terms as well as changes to standard central bank policies were both comparable and widespread. Generally speaking, Canada fared very well where most of the front-end programmes were actively used at the onset albeit for a short amount of time. The vast majority of liquidity was generated by way of the term repo facility which was the most active and longest standing — the Bank of Canada (BoC) discontinued the Commercial Paper Purchase Program, the Provincial Bond Purchase Program, and the Corporate Bond Purchase Program on 23 March 2021 and the Term Repo operation on 10 May 2021.

Trapp: While many of the BoC liquidity facilities are still in play, starting in the fall of last year, the BoC began scaling back purchases of Canada treasury bills and discontinuing the Provincial Money Market Purchase Program. Just last month, BoC became the first central bank to signal an end to the stimulus brought about during the pandemic and began scaling back the bond purchasing programme from CAD $4 billion to $3 billion per week.

The Canadian securities lending market has always been in a strong position due to the majority of collateral accepted is non-cash. This allows borrowers to efficiently manage their balance sheets without having to rely on cash collateral. The flood of liquidity from the Central Banks has resulted in a lack of specials trading in the Canadian Government Bond (CGB) market. It has not had an impact on equity specials demand, as the focus on single name stock has continued. There has been an interest in pledging equities as collateral for CGBs as borrowers have looked to maintain or upgrade their balance sheets while demonstrating secured financing. This has given rise to opportunities in the Term market for holders of HQLA assets.

Kolasingh: The volatility of early 2020 and resulting economic impact necessitated significant central bank intervention to ease liquidity concerns and financial fallout, both here in Canada and abroad. As a result, markets stabilised relatively quickly. During Q1, both the US Federal Reserve and the BoC introduced changes to their quantitative easing programmes, as well as the discontinuation of programmes introduced during the COVID-19 pandemic. In Canada, the BoC announced changes to a number of programmes as the market outlook continued to improve. On the other hand, the BoC also increased total bidding amounts within its securities repo operations to ensure liquidity in tighter mid-curve bonds. This intervention, combined with all-time low interest rates, ultimately provided alternatives to the liquidity once sought in the securities lending market. As a result, demand for term lending softened in 2020, with some borrowers reducing existing structures taken on prior to the COVID-induced market decline. Such demand has historically been concentrated around level one and level two assets, Canadian government bonds and provincial debt. While demand for Canadian government bonds persists, albeit at lower levels, demand for the provincial debt has tapered due to alternative sources of liquidity and collateral optimisation.

During this period we had very specific discussions with clients and counterparts about risk and controls and individual client risk tolerances.

Clients valued the constant communication and globally remained comforted with our business strategy.

Herron: The industry as a whole fared extremely well during the COVID-19 pandemic and communication was excellent between agents and their clients, regulatory and trade bodies, as well as banks, borrowers and counterparts. At J.P. Morgan we invest heavily in technology and resiliency plans and we were able to transition to a remote work arrangement immediately without issue. Communication was vital internally with our teams and various support staff partners and externally with clients and counterparts. Our approach was to err on the side of caution and over communicate, heighten focus on risk, controls and data and remain in constant contact with all parties. We proactively reached out to clients multiple times per day to provide updates on market events and opportunities and to flag heightened risks. As an agent, we were focused on settlements, liquidity, collateralisation, corporate action events, counterparty credit risk, market events and opportunities.

Triparty platforms were helpful to facilitate seamless securities for securities substitutions while maintaining all relevant eligibility parameters and requirements. The acute drain on liquidity and increased market volatility during that initial period resulted in record sale volumes, significant increases in loans, collateral substitutions and mark-to-market processing for securities lending businesses and clients generally.

Tomada: Canada's financial markets shared in the significant disruption triggered by the global COVID-19 pandemic. The market correction that followed from the onset of COVID-19, during the peak period of March 2020, saw tremendous volatility and extremely high volumes of investment operations. This came in concert with the profound operational transition which saw financial institutions adapting and expanding remote work environments and business continuity actions, while also handling an unusually high spike in volume. For example, according to our research, two-thirds of Canadian pension funds had concerns about liquidity during the pandemic crisis. Almost all said their future investment decisions will be influenced by this experience, and nearly half said COVID-19 has prompted a review of outsourcing plans. I think we saw the continued role of securities finance in enabling that market liquidity, as well as the level of engagement of Canadian beneficial owners in lending generally, play out through the depths of the crisis as, from our perspective, this market function performed well.

Canadian governments at the federal and provincial level also stepped in with an array of relief measures to support individuals, businesses and the broader economy through the pandemic while working to 'flatten the curve'. The BoC reduced its benchmark lending rate through a series of rate cuts during March 2020 in response to the pandemic. Other stabilising measures were also launched by the BoC in order to support and uphold the stability and functioning of Canada's financial system. For example, the BoC established several large-scale asset purchase programmes to help enable liquidity. With those measures, Canada's financial system remained stable during the height of volatility and continues to properly function in the 'new normal'.

Furthermore, in response to challenges related to the COVID-19 pandemic, Canadian tax authorities developed some significant tax measures to support Canadians and businesses. For instance, for Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) information returns, the filing deadlines for Part XVIII (FATCA) and Part XIX (CRS) returns were extended to 1 September 2020. In addition, no penalty will apply for failure to obtain a self-certification on financial accounts opened before 1 January 2021.

During periods of volatility, communication between stakeholders becomes more important than ever. How did agent lenders tackle the pandemic troubles on behalf of their clients?

Kolasingh: At RBC I&TS, we maintain a close dialogue with our clients to help them navigate tumultuous periods. This was particularly important during the early months of the COVID-19 pandemic and collaboration will continue to be a key tenet of our programme going forward.

The market volatility experienced globally in the spring of 2020 translated into a significant surge in securities lending activity and risk management was a particularly important topic for us to discuss with our clients during this time. Beneficial owners took broad-based positions to hedge rapidly changing market conditions, and this resulted in increased transaction volumes in addition to higher loan reallocations and recalls. As a result, we had numerous conversations with our clients about the parameters in place to support lending activities and balance investment decisions, reassuring them of the rigorous risk management protocols within our securities lending programme. It was important to emphasise RBC's strong balance sheet and the protections that our contractual indemnifications provide.

Trapp: Communication is key, specifically during times of significant market events like the COVID-19 pandemic. Northern Trust securities lending placed a strong emphasis on communication with our clients, specifically on the impact on the fixed income and equity markets as well as providing assurances around our risk management protocols, counterparty and collateral monitoring processes. Our 40 years of experience as an agent lender was key to our success during the pandemic. The single most important issue we dealt with was ensuring the business was successfully transitioned to a remote work environment without impacting our clients or borrowers. This was happening at the same time our client's and borrowers were also figuring out how to transition their businesses. Northern Trust was able to support our clients and our securities lending business throughout the transition period as we moved trading, client relationship management and our operations teams to a remote environment without any business disruption. Northern Trust remained committed to our clients revenue and client servicing needs throughout the pandemic and positioned ourselves to take advantage of demand opportunities.

Grossman: At the onset of the pandemic in March 2020, State Street placed emphasis on ensuring the smooth transition of its employees to a work-from-home environment, to maintain a business-as-usual service model, in addition to providing proactive and more frequent communication with clients. Client managers provided clients with increased transparency into the market's impact on their agency lending programmes, while also delivering focused communications on the enhanced risk monitoring in place in order to help alleviate their concerns during periods of extreme market volatility.

For clients looking to adjust lending parameters in order to accommodate additional liquidity needs or portfolio rebalances, State Street quickly accommodated them to bring programmes in line with revised objectives. This demonstrated how we, as an agent, can tailor clients' programmes based on their specific requirements and risk profiles. Additionally, for further client support, regional securities finance-specific calls were organised to allow for clients to hear from State Street's senior

"The broader outlook for Canada is similarly aligned with the goals of other countries, where a successful vaccination roll-out is expected to show the light at the end of the tunnel"

Chelsea Grossman
Vice president and head of securities finance Canada business development and client management
State Street Global Markets

management, specifically on relevant market trends or impacts, as well as any updates with respect to our agency lending programme. In these same sessions, clients were able to pose questions to senior management directly, for which positive feedback was received.

Tomada: CIBC Mellon knows how strongly clients value resiliency and robust governance. To this end, we are committed to sustaining resilient capabilities designed to maintain operations in the face of business disruptions. Our response to the pandemic was underpinned by our business continuity programme, and this supported the stable delivery of products and services to our clients throughout this pandemic. We continue to maintain open lines of communication and collaboration with our employees, clients, vendors and other stakeholders to work through these challenging times together.

One critical aspect that we found was both a key achievement and a major success factor: staying connected and keeping communications channels open even as we were physically separated. Our teams actively engaged with clients and employees, keeping them informed — for example, frequent employee, management and leadership meetings, detailed and regular client updates across multiple formats, and regular employee calls and messaging.

Looking ahead, economic recovery seems intrinsically linked with the vaccine roll out. What is the broader outlook for Canada going forward and how will this impact the securities finance market?

Grossman: The broader outlook for Canada is similarly aligned with the goals of other countries, where a successful vaccination roll-out is expected to show the light at the end of the tunnel, and ultimately lead to increased mobility and an economic re-opening. While many aspects of the securities finance market have adjusted to the new, somewhat isolated, work-from-home environment, there are areas of optimism that correspond with economic recovery. For one, institutional lending clients are sensitive to market stability, so an economic recovery in Canada would allow for them to further engage and potentially do more with their lending programmes. From a lending perspective, a more stabilised economy could reintroduce further conviction from market participants, which could also be expected to result in increased short-activity and therefore hard-to-borrow 'specials' in the market, impacting fees and revenues in a positive way. Finally, the ability to return to the office and travel to see clients is one of the many things we look forward to, although it remains to be seen how in-person interactions will be rolled out among the various countries and corporations.

Tomada: Across evolving headlines around vaccine deployment and new strains, it is as yet impossible to say how long the uncertainties of COVID-19 will endure in Canada.

Regardless, global investors and market participants in Canada continue to focus on risk mitigation measures, new technology and modern architecture. The Canadian market is buoyed by its strength, stability and transparency and Canada still holds on to its fundamental character for which it is recognised globally.

While 2020 has been a challenging year for markets, investment operations and for many individuals, market participants and stakeholders have worked hard to deliver on the fundamental themes that distinguish Canada: confidence, stability and innovation.

Trapp: Canada has always been supported by a strong economy and well-capitalised banks and financial institutions. Securities lending is a global product and our clients hold diversified portfolios across Canada, the US, Europe, and Asia Pacific. It is Northern Trust's responsibility to make sure we are maximising securities lending revenue for our clients irrespective of the impact in any specific region. What we have seen is that the vaccine roll out has been different around the globe and how that translates to securities lending demand is not clear. What is important to our clients and borrowers is to have a regionalised programme set up to react to any market demand or events within the securities lending market. Northern Trust has trading desks in London, Toronto, Chicago, Hong Kong, and Sydney to cover all regions for our clients.

Herron: The Canadian economy is heavily centred on financials and industrials, two sectors that remained open during the pandemic. The strength of those sectors will remain integral to any recovery. The cannabis sector remains of interest with companies awaiting lockdowns to end, so as to allow stores to open and sales to increase. Hedge funds have remained active in the market and we expect this should continue to increase, going to hopefully grow revenue in securities finance.

Schuessler: Recovery does seem intrinsically linked with the vaccine roll out, however, there remains a cloud of uncertainty in predicting if we truly are at the end of this pandemic and the impact of all the stimulus already provided. There are virus variants posing risks, potential overvalued markets and slower vaccine roll out in Canada. These factors tend to point to some continued volatility for at least the short term. Looking forward, volatility when healthy is generally positive for the securities finance industry and I think many of the trends of 2020 will continue through 2021; continued high interest in the SPAC space and alternative asset financing, potentially further consolidation within the cannabis sector and as borrowing levels remain at historic lows we may see additional merger and acquisition (M&A) activity as well.

Kolasingh: Despite ongoing lockdown conditions, the Canadian economy continues to show resiliency with month-over-month headline GDP growth that is sometimes faring better than initial estimates. Equity markets remain strong and the securities lending market is demonstrating ongoing resiliency.

As to the Canadian securities lending market, RBC I&TS is paying particular attention to improving conditions in the demand for term structures, while seeking pockets of intrinsic value from market and corporate events for our beneficial owners. Demand is returning due to the ongoing stabilisation of financial markets, albeit in a different way. Fixed income demand for HQLA remains steady, while the demand for HQLA on term as of Q1 2021 surpassed 2020 as a whole. However, term structures are not as long-dated and fees have softened. This is not unexpected given alternative avenues to liquidity provided by central banks. On the equity side, the cannabis sector has consistently been the number one driver of incremental revenue since legalisation in Canada on 17 October 2018. While demand was substantially subdued and essentially muted in the second half of 2020, we are confident that, as financial markets improve and consolidation activity increases, securities lending opportunities will return.

There have been rumblings of anti-short selling sentiment (within regulatory bodies, politicians and potential shorter targets) in Canada for some time but that appears

to have developed more recently. What's going on here and do you predict anything substantial will come from this to curb short selling?

Kolasingh: In 2020, the Canadian Securities Administrators (CSA) published the CSA Consultation Paper 25- 403 – Activist Short Selling in an effort to formalise the discussion on activist short selling. According to the CSA, "short selling, as a trading activity, is subject to a well-developed, risk-based regulatory regime". In addition, the BoC noted that short selling is a tool that promotes liquidity, enhances price discovery and prevents settlement failure. When investors have the ability to take both sides, the mechanism of price discovery is much more efficient. It is important to note that securities lending goes beyond short selling and includes other important market facilities such as market making, funding, prime brokerage and collateral optimisation. It is also important to remember that regulators have a vested interest in a financial services industry that is based on sound, stable and transparent practices.

Grossman: Short selling often faces scrutiny across global markets, especially during market downturns, so the ramp up in anti-short selling sentiment has not been unexpected given the circumstances around the COVID-19 pandemic. More recently, headlines around Reddit and GameStop, as well as Credit Suisse's exposure to Archegos, have further fueled those conversations. With that being said, these events are partly a testament to why short selling is not bad.

When markets went haywire around GameStop, we saw no sell fails, meaning owners were able to sell and settle their trades within settlement cycles. In essence, the lending universe did what it was engineered to do, which was provide liquidity to the market during a time of stress. It is also important to note that the Reddit-affected positions were targeted, security-specific issues, rather than broad market or sector events. Still, these incidents are currently under review by regulators in terms of their market impacts, so it remains to be seen what potential regulatory changes will be imposed by governing bodies. What the lending market has felt more broadly as a result of GameStop/Reddit/Archegos events is a hesitancy by end-users of the loaned securities to crowd their short positions, which has exacerbated the lack of hard-to-borrow stock in the current market.

As these trends develop, State Street continues to keep in close touch with our borrowing relationships, carefully monitoring the market movements and pending regulatory changes around these recent issues. Overall, we continue to see the benefits of short selling in the market as it has been shown to contribute positively to price transparency as well as liquidity.

Schuessler: Yes there has been much discussion in the past year over anti-short selling and the role regulators play in this regard. I have seen more and more industry organisation get involved to provide comment letters and responses to regulators. I think there is a large element that involves education and has seen more publications around this. In line with the focus towards environmental, social, and governance (ESG) and how short selling fits in, there are new organisations like Global Principles for Sustainable Securities Lending (PSSL) helping. Global PSSL's goal is to create a Global ESG Market Standard for owners, lenders, borrowers and impact creators. CALSA's mandate seeks to enhance the public's understanding of securities lending and the role it plays in Canada's financial markets which also embodies the education piece around short selling. I don't predict anything substantial will come to curb short selling but possibly further regulations/disclosures may come.

Herron: Short selling has proven time and again to be an effective mechanism to balance markets, provide efficiency, liquidity and price discovery. Short selling has also played a role in highlighting corporate mismanagement, accounting irregularities and outright fraud. However, from a headline perspective short selling does tend to carry negative connotations and in many global markets, an anti-short selling sentiment seems to be cyclical. It is important to educate against misconceptions and highlight various studies performed by global regulatory bodies that support the value of transparent permissible short selling.

In addition to the market benefits, another aspect often overlooked or excluded from commentary is the economic value that securities lending offers beneficial owners, for example, Canadian pensioners. The pensions, insurance companies, retirement account mutual funds that own the assets supplied to cover and settle a short sale are paid economic returns for the usage of their idle assets. This extra income increases the returns to 'main street' and helps companies meet their obligations and/or offset expenses.

Specifically, as it relates to Canada, short selling is regulated and we do see efficient short selling continuing, offering all the market benefits studies have highlighted. We do expect certain levels of due diligence will be performed by industry regulatory bodies and industry participants, but given the controls already in place, we are not anticipating wholesale changes. Demand tends to increase at times of volatility and as an agent, we are seeing opportunities in certain sectors, mentioned previously, and for specific event driven names as M&A have remained strong in Canada

Tomada: While short selling bans intend to limit exaggerated price movements, and to prevent artificially pushing stocks below fundamental prices, a host of research finds that efforts to prohibit short selling during market downturns can instead lead to increased trading costs and reduced market liquidity, while also preventing short sellers from exposing potentially destructive market manipulation.

Canada's industry associations and regulators have taken the view that short selling is part of the functioning of our sophisticated market. Unlike some other jurisdictions that decided to ban short selling outright or certain asset classes temporarily, Canadian regulators did not seek to ban short selling during the extreme market volatility experienced in March of last year, when the pandemic was first declared.

Trapp: Where we see a shift in the market is toward ESG and how that should be implemented at the securities lending level. Securities lending programmes can coexist with ESG principles. There are two main ways clients are addressing ESG in their lending programme: through their policy on proxy voting and collateral acceptance. A client's lending policy should reflect their unique ESG preferences, so this means clients may not choose to lend certain securities because they want to vote their proxies. Another area that we see clients considering ESG is in the types of collateral they hold, whether it be securities collateral or through their investment of cash collateral. A client may decide to restrict certain areas of investment to reflect their ESG preference.

On a side note, we were glad to see Korea begin lifting its short selling ban at the start of May. Most of the restrictions that were put in place by regulators globally were short lived

"CASLA has been tremendously helpful in organising various participants who operate within the Canadian Securities Lending market to focus on long-term viability and the adoption of best practices"

Jack Herron
Vice president, agency securities lending international equity trader
J. P. Morgan

For CASLA specifically, what has been the association's focus over the past year and what is on the roadmap for the future?

Tomada: The Canadian Securities Lending Association's 10th Annual Conference on Canadian Securities Lending, covered industry and regulatory trends in the agent lender and borrower communities, it held discussions on the economic impact of the COVID-19 pandemic, mainly focusing on the buy-side and its perspectives, and the role of government and market reactions toward the 2020 pandemic versus the 2008 financial crisis.

The afternoon panel discussion on buy-side perspectives during a pandemic was moderated by Stephen Novo, executive director, prime services group – securities lending, CIBC Capital Markets. The session focused on how COVID-19 has impacted the Canadian hedge fund industry and what steps the industry has taken to adapt to the current environment.

From 9 to 10 June 2021, CASLA will hold their 11th annual conference. CASLA's guest speakers will include Benjamin Tal, managing director and deputy chief economist and journalist Bethany McLean, known for her writing on the 2008 financial crisis. The panels will discuss the evolution of securities lending, the highs and lows of 2020 and the increasing role of technology across the industry; opportunities, challenges and its future state.

Schuessler: CASLA has had an active year despite the pandemic and although we didn't get to celebrate our milestone 10-year anniversary last year we have undergone some interesting work. ESG has continued to be a focus for CASLA this year as we became a contributor to GPSSL's strategic themes paper and continue to work alongside this social enterprise to further the progression of this critical aspect of the financing industry. CASLA continues to work closely with regulators on aligning the risk/reward metrics specific to the institutional beneficial owner community. For the future, CASLA would like to continue to work closely with their industry peers through dedicated working committees that have been formed in the past year. CASLA will continue to support its main mandate of ensuring the long-term viability of the Canadian securities lending industry and the adoption of best practices.

Kolasingh: Like many areas of the industry, 2020 was a year of change for CASLA and, as the association's coordinator, I look forward to supporting its future endeavours. Over the past year, CASLA revitalised our board of directors, launched two additional subcommittees and welcomed a number of new member firms in order to broaden our scope and impact across the Canadian securities finance landscape. Led by our volunteer member firms, the new tax and regulatory and events and engagement committees will drive greater interaction and discussion as our industry evolves. Looking forward, CASLA will continue to actively engage with stakeholders, assess the changing regulatory landscape and participate in industry discussions on behalf of our members.

Last year was the 10th anniversary of CASLA's annual conference on Canadian Securities Lending, which has become an extremely popular event. However, due to the pandemic and not unlike other in-person events, we held our first virtual conference this past November, which was attended by over 300 delegates. This year, we are excited to be hosting the annual CASLA Conference — a two-day virtual event featuring a number of panels and guest speakers covering a range of topics, including ESG and the Canadian economic outlook, as well as various emerging trends and the future of securities lending.

Herron: CASLA has been tremendously helpful in organising various participants who operate within the Canadian Securities Lending market to focus on long-term viability and the adoption of best practices. CASLA's virtual presence in 2020 was extremely educational, but as with any virtual forum unfortunately lacked the networking aspect, which also affords opportunities to continue conference discussions.

Going forward, we hope to see CASLA continue to focus on updating the marketplace on changes within the CAD securities lending market; helping borrowers, lenders, triparty agents, and vendors interact to develop economically beneficial opportunities; and promoting continued efficiency and best practices for all parties. It will be interesting to see how the remote working environment will re-shape organisations moving forward and where the Canadian firms stand on that topic.

Grossman: State Street's Canadian securities finance programme, via its involvement with CASLA, has been focused on several key topics regarding the future of the securities finance business. In the current environment of increased lending supply, with an emphasis on balance sheet usage and adherence to regulatory limits, the use of collateral and its efficient movement in the market has become increasingly important. Other relevant topics include ESG, specifically how a client's lending programme can align with their ESG values, and the future of digital currencies and ledgers, including how these can be incorporated into the lending market.

ESG: look before you leap

Drew Nicol reports

The ultra-high growth ESG sector claims to have laudable aims of offering investors a way to support the transition to a more sustainable world, but is market enthusiasm creating a breeding ground for fraud? Short sellers think so

A trifecta of pent-up buying power, a zealous demand for sustainable assets from both institutional and retail investors, and the global political push to 'go green' is coalescing to push major indices to record highs; but cynics are raising concerns that these forces are also creating a perfect breeding ground for market malfeasance.

Legendary short seller Jim Chanos, who made his name predicting the downfall of Enron and, more recently, Wirecard, has repeatedly dubbed the current market environment, "the golden age of fraud". He argues that the reflex to decry negative headlines as 'fake news' now means some bullish investors are unable to accept that their portfolio contains bad apples until the company's management are marched out the front door in handcuffs.

The fall of Wirecard last year was widely seen as a vindication for the short sellers and journalists that had doggedly waved red flags over the German payment processing giant's accounting discrepancies for years in the face of legal threats from the firm and even the German regulator. It was a watershed moment where market sceptics were, for a brief moment, seen as invaluable whistleblowers, not vultures seeking to profit from others' misery.

More recently, as the West emerges from the COVID winter, many activist short sellers are pointing to widespread examples of firms using the market's emphasis on allocating to environmental, social and governance (ESG) to support the recovery effort as a way to subvert scrutiny and lull well-intentioned investors into parting with their money.

"Fraud follows the financial market cycle with a lag", Chanos, founder and president of Kynikos Associates, said in a Bloomberg TV interview in December 2020. The S&P 500 regained all of its Q1 2020 COVID losses as of August and hasn't looked back since. The index is up 10 per cent year-to-date and 44 per cent since May 2020. The longer a bull market runs, the more likely investors are to suspend their disbelief to avoid missing the next hot thing. In such an environment, those able to help stamp out fraud and malfeasance must also rise to the occasion.

Moreover, the stakes have been raised even higher than previous bull runs given the surge in retail trading by millions of cash-rich individuals stuck at home over the past 18 months. Robinhood, a US no-fee retail broker, welcomed more than 3 million new customers in 2020, while other cheap online trading platforms have also surged in popularity around the world. Many of these new market entrants are believed to be younger than the average age of investors and entering the world of stocks and bonds for the first time. These amateur day traders disproportionately favour stocks with sentimental or ethical value, which in some cases leads to the recent furore around so-called 'meme stocks' but more often leads them to ESG-friendly assets.

Beware the big green bubble

In the 12 months following their inception dates, ESG equity funds attracted on average €95 million, compared with €70 million for non-ESG funds, according to data from the European Securities and Markets Authority published in March. In the same report, the regulator highlighted that, based on a sample of 880 equity and mixed funds that rebranded as 'ESG friendly', equity funds attracted on average five times more net flows in the 10 months after conversion than in the 10 months before, while mixed funds were able to stem outflows.

Elsewhere, exchange-traded funds (ETF) that track ESG indices chalked up 223 per cent growth over 2020, achieving a new record of $189 billion in combined assets under management, according to TrackInsight. Green-wrappered funds captured $97 billion of inflows last year, while 200 new ESG ETFs were brought to market during the same period.

How much of these inflows came from idealistic market newcomers is impossible to know, but the fact regulators in the US and UK have recently warned retail traders against taking their investment leads from social media and celebrity-endorsed special purpose acquisition companies (SPACs), suggests they are worried the Venn diagram overlap is substantial.

As strong tailwinds for the ESG sector intensify, fears are being raised from several quarters — from regulators to industry associations and financial institutions — that the ideological underpinning of the investments will cause thorough due diligence to fall by the wayside and allow bad actors to divert significant capital into their coffers by presenting a disingenuously sustainable face.

This pernicious trend, known as 'greenwashing', is not exclusively a problem for the cleantech sectors and similar market segments. According to the results of a survey by the Alternative Investment Management Association and KPMG of 135 institutional investors, hedge fund managers and long-only managers in 13 countries, bad practices also exist right across the investment industry.

Within the hedge fund industry, 41 per cent of survey respondents report a 'significant amount of greenwashing'; 11 per cent report 'some greenwashing'; and 48 percent are 'not sure'. None of the respondents thought there was a 'minimal amount' of greenwashing.

The report based on the survey cites the lack of good ESG data as a core contributor to the proliferation of greenwashing and noted that these teething problems will likely be weeded out as sophistication in this sector develops.

The problem extends across the gamut of active and passive fund options, with ESG ETFs, in particular, coming under scrutiny for touting market-beating performance tracking an ostensibly ESG index that on closer inspection is heavily weighted with household name technology stocks, with only a mild peppering of overtly ESG constituents.

Moreover, the third-party ESG ratings that these funds use to rank their indices and funds vary wildly in their methodologies, thereby allowing fund issuers to shop around for the most favourable rating. The next phases of the Sustainable Finance Disclosure Regulation are expected to address these issues, in the EU at least, but until then investors must take on the onerous task of comparing and contrasting ETF prospectuses and scrutinising their underlying ESG rating calculations.

Bear hunters

As investor confidence reigns supreme, the counterbalance of market scepticism is arguably needed now more than ever. The rise of ESG may prove to be a unique opportunity for short sellers to recast themselves in a new light. By weeding out nefarious companies and generally holding a quizzical light up to expose ESG fraud and hypocrisy, short sellers may be able to align with broader market sentiment in a way they have never been able to before.

A slew of reports from activist short sellers highlighting suspected malfeasance by firms claiming to be part of the ESG paradigm shift have already been published so far this year, but the bears are facing significant pushback from several angles. On the face of it, it's hard to be a short seller in a low interest rate bull market, but the rise of anti-short selling retail investors seeking to flex their collective investment muscles is making the situation worse.

The retail army has claimed several big scalps so far including Melvin Capital and Citron Research, both of which were badly burned during the GameStop short squeeze. The latter subsequently bowed out of publishing short reports after 15 years in the business, following a wave of online abuse.

However, those seeking to crush short sellers are also stripping away an early warning system that could alert them in the event that an investment prospect may not be all that it seems.

"Is the market better off with Citron Research not doing any more short reports because of the abuse that they've taken over GameStop," queried Roy Zimmerhansl, practice lead at Pierpoint Financial Consulting, during a recent webinar by the Chartered Institute of Securities and Investments, in partnership with SFT.

"We will need more people checking greenwashing credentials rather than fewer," he adds. "Partly that's because people will make mistakes and genuinely think that they're complying, as well as those people with more malevolent goals."

Zimmerhansl, who also serves as a member of the college of advisors for the Global Principles for Sustainable Securities Lending (Global PSSL) — a not-for-profit aiming to create a unifying set of ESG principles for the global market — further noted that Wirecard and NMC Health, another recent high-profile short target, were members of mainstream indexes, the DAX 30 and the FTSE 100, respectively. "I don't recall a lot of long investors or passive index holders calling out fraud and I don't recall regulators or auditors doing it, I saw journalists and short sellers doing it."

This view is compounded by Peter Hillerberg, co-founder of data analytics firm Ortex Financial, who told SFT in the immediate aftermath of the Wirecard scandal that hedge funds are reinventing themselves as the fact-checkers of capitalism.

"As trust erodes in the traditional structures that previously held companies to account, new ones will need to emerge," he argued. "It looks like the historic bad boys of finance may be about to become the good guys."

Despite the public pillorying of hedge funds on Reddit forums and even by US Senators following the January GameStop episode, some short sellers appear uncowed.

Hindenburg Research and Spruce Point Capital Management are among the most prolific activist short sellers in the game today and have highlighted multiple examples of firms allegedly trying to ride the green wave despite having less than stellar ESG fundamentals.

From clean energy to healthcare, and electric vehicle battery manufacturers, these funds and those like them are finding the blossoming ESG landscape to be a rich hunting ground of short targets.

In fact, following the initial meme stock saga, Hindenburg made the highly unusual decision to release its findings from a four-month investigation into apparent misconduct by Clover Health, a US healthcare provider that went public via SPAC, alongside a declaration it had not taken a negative position ahead of time. This apparently altruistic move was taken to highlight the role activist short sellers play in uncovering fraud and malpractice, the fund said.

Explaining its decision, Hindenburg stated: “Short selling is always high risk, these are unprecedented times; many people are angry and right now we believe it is important to demonstrate the role short sellers play in a healthy, functioning market.”

Short selling reports are often dismissed by the subject of the investigation and its long investors, who highlight the financial incentive a hedge fund has to apply downward pressure on prices, which may lead it to exaggerate a company’s flaws.

In the ESG space, there is the additional defence of framing the accusations as a greedy hedge fund attempting to profit from destroying a company that’s doing something good for the world. This tactic can serve to stir up significant social media support for the accused company and vitriol against the hedge fund, extending to death threats and doxxing — where the personal details of the fund’s employees, and their family members, are made public.

“We are taking that off the table for this one report so the investing public can more clearly see the work for what it is; deep-dive investigative research,” Hindenburg stated.

The report, ‘Clover Health: How the “King of SPACs” Lured Retail Investors Into a Broken Business Facing an Active, Undisclosed DOJ Investigation’, claims that the “corporate world is rife with fraud, and investors have little protection”.

In the vacuum of regulatory, moral and journalistic oversight, Hindenburg argued, “short sellers, like us, have stepped further into the role”.

So do these examples mean short sellers are fully embracing the role of vigilante ESG market watchdog? Not quite.

Hiding behind the greenscreen

At Global PSSL’s inaugural public roundtable, a group of prominent short sellers including Muddy Waters’ Carson Block, discussed their role in the new ESG-centric world.

Answering SFT’s question during the Q&A on how short sellers could approach highlighting a firm’s ESG failings, Block said that activists had to exercise caution as allegations of ethical shortcomings often come across as “sandbagging”, rather than solid investigative work.

He explained that many companies Muddy Waters has identified for financial malpractice often also had poor standards around their ‘E’ and/or ‘S’ practices, but he often did not allude to them in reports as investors either won’t care or it will undermine and dilute the core financial argument.

However, “in the right situation we might experiment,” he conceded, stating he would consider publishing a short thesis that highlighted where a fund was publicly claiming to maintain strong green practices, for example, but was doing the opposite behind the scenes.

Fellow panellist Gabriel Grego of Quintessential Capital Management put it another way: “There is never only one cockroach in the kitchen.” He explained that organisations in financial difficulty will often cut corners in expensive ESG best practices, meaning evidence of poor standards can be an indicator of a deeper rot.

"In some rare cases you can make a very good case based primarily on ESG and, in others, you could add a small part to your report that stated that as well as being an accounting fraud a company also mistreats employees and the environment," he stated. "ESG is certainly something we should keep in mind."

Meanwhile, Anne Stevenson-Yang of J Capital Research told the virtual audience she was not optimistic that investors would get wise to ESG fraudsters' tricks any time soon as "the hype bounces from sector to sector".

"About 90 per cent of the electronic vehicle sector is a grift, and that's true of a lot of these [ESG] sectors," she argued, without naming names. "Any area where the technology is difficult to understand and big, extravagant promises can be made, it will be rife with fraud."

Like Block, Stevenson-Yang argued that, fundamentally, hedge funds had to primarily consider whether other investors will care about their findings of a short target's misdeeds and question whether their report would stimulate the market into a sell-off action or not.

The roundtable was held as part of unveiling a first-of-its-kind voluntary ESG standard on short activism.

Global PSSL, as a voluntary high-level code, comprises nine principles that align securities lending participants with their ESG ambitions.

Principle five is dedicated to short selling and was developed by the short activist representatives — also including Bronte Capital's John Hempton — and Global PSSL CEO and founder Radek Stech.

At the launch, Block stated: "Short selling is a venture involving high risk to the individual. But, by its very nature, short activism exposes bad governance, scams, and fraud. It's reassuring to see someone like Radek co-create a voluntary framework for short activists to prove their ESG credentials."

The fundamentals of the trade remain unchanged but, attempts to codify ESG across market segments will undoubtedly smooth the transition to a world where considerations around sustainability are front-and-centre in all front-office operations, even shorting.

Don't sleepwalk into fraud

In the post-COVID world, where the EU and the Biden Administration have pledged to make ESG a central pillar of economic recovery, vigilance in upholding these standards will be paramount.

> ***"Ultimately, every individual investor, big or small, is responsible for maintaining robust due diligence practices and taking a good look before leaping into an investment just because it's enjoying the spotlight for a moment"***

Ultimately, every individual investor, big or small, is responsible for maintaining robust due diligence practices and taking a good look before leaping into an investment just because it's enjoying the spotlight for a moment. But, some assistance from the professional sceptics may also help the most bullish in avoiding a wipeout.

The road to hell is paved with good intentions, don't let affection for electric vehicles allow you to be taken for a ride.

Securities Finance Technology Symposium 2021

Alex Pugh reports

SFT's online symposium took a forward-looking approach despite the unforgettable events of 2020 and 2021

Panellists representing fintechs, lending platforms, post trade, and other securities finance firms navigated the intersections of technology, regulation and, of course, the pandemic within the industry at the Securities Finance Technology Symposium 2021.

Discussion on collateral, repo, regtech and treasury departments and the effect of emerging technologies on these areas, fostered some valuable insight for those watching remotely.

Innovation in repo markets

When it comes to repo, it was widely agreed that the COVID-19 pandemic has been a much-needed catalyst for change.

"Unlike back in those early days when the technology wasn't there, the tools are available today and it's unclear why we aren't further forward," the panellist representing a fintech provider lamented.

There has been frustration among repo market participants in recent years, with technologists struggling to convince those holding the purse strings to allocate much-needed resources to infrastructure upgrades.

Another speaker acknowledged that decision-makers may have been hesitant to leap into new frameworks that would cause disintermediation or require legacy technology stacks to be mothballed.

"New technology is a disruptor in most cases, and repo is still a relationship business," the speaker noted, which has led to a suspicion that new tools would cause more problems than they solved. "Change is happening now but not necessarily because people want to do it but because they have to," they added.

Technologies driving adoption

As new routes to market bring a more diverse range of participants to repo markets, especially from the buy-side, the overall market is likely to continue to grow in size and importance, a separate panellist concurred.

New and existing regulations have also been driving the need for enhanced technology in the collateral space, according to one expert.
There has been heavy investment in the past decade in order to comply with regulations such as Dodd-Frank and the European Market Infrastructure Regulation.

Other drivers of technological adoption in the collateral space relate to achieving sustainable efficiencies through simplifying overall systems' landscapes. "We have seen different initiatives to simplify IT systems within banks through to the collateralisation of over-the-counter derivatives, then the move to securities financing trades and exchange-traded derivatives," the panellist said.

> ***"Change is happening now but not necessarily because people want to do it but because they have to"***

The rise of electronic trading, peer-to-peer platforms and treasury tools to gain greater oversight and control over a firm's book has reduced friction within the market, the panel suggested.

The panel also agreed that recent regulations, primarily coming out of the EU, are stimulating the adoption of new technologies to meet reporting requirements and avoid penalties for settlement failures.

This greater emphasis on financing has come in tandem with the heightened demand for liquidity, also largely driven by regulation, as well as the emergence of collateral efficiency as a key growth area within both buy and sell-side entities. The ability to post collateral optimally hinges on having effective oversight of an institution's entire balance sheet, and that has led to repo taking centre stage for the first time.

"We're at a point now where there is no going back," one panellist ventured.

Reducing IT infrastructure costs by building and maintaining connectivity and interfaces, using cloud technology and onboarding open source systems, all lead to efficiencies, it was explained.

Efficiencies can also be created operationally too. "If you use a unique system you will of course have one system to automate your margin call and you will have synergies between all the teams you have," the panellist added.
A further, final driver is a technical one, the panellist highlighted. "We have seen recently that global institutions are progressively adopting a component-based thinking." Having components that are non-intrusive, easy to integrate and that bring value quickly constitute much of recent investments, the panellist concluded.

The data exists for those who can standardise it

There are three things a successful treasury function must have, according to a panellist discussing centralised treasury functions: a real-time view of your balance sheet; an optimisation engine to take inputs, and to create the desired outputs; and an overlay with collateral mobility to enhance the optimisation.

Treasurers lost in a sea of unstandardised data are now being offered a variety of life rafts from vendors offering to replace their creaking legacy systems with centralised, modular solutions.

> *"This need for the data to be at your fingertips is absolutely essential and there's no good trying to do it in the middle of a crisis, it needs to be laid out visible, working with you every day"*

"The key requirements for a central treasury function to be successful are not rocket science," argued one vendor panellist.

In practice, for a buy-side firm to receive multiple reports from its various prime brokers, custodians, clearinghouses, and elsewhere, and standardise that in order to turn it into actionable data is much harder than it seems, a second panellist representing a global fintech service provider countered.

Referring to the 2020 COVID-19 volatility that caused a major spike in margin calls, a panellist noted: "This need for the data to be at your fingertips is absolutely essential and there's no good trying to do it in the middle of a crisis, it needs to be laid out visible, working with you every day."

Despite the cohesive vision of what an optimal treasury function looks like, there was less consensus among the wider market on how to get there.

The panel agreed that medium and large buy and sell-side institutions should not create a bonfire of legacy technology stacks tomorrow, and dive straight into adopting agile, centralised systems, but instead opt for modular service offerings which allow entities to replace their systems piecemeal as and when resources allow.

Vendors are ready to provide tools to sift, sort and prioritise what's needed from the sea of data. All treasurers need to do is take the plunge, the panel concurred.

The future of regtech

When it comes to predicting the future, everyone has their own forecasts for what the 'next big thing' will be. Some emerging technologies seem perpetually on the cusp of becoming mainstream, while others seem to come out of nowhere and upend industries seemingly overnight. Securities finance is no different.

Despite all the hype, securities finance is still sleeping on the true power of blockchain, according to a panellist who discussed the distributed ledger technology and its use in securities finance.

"I know a few of the central counterparties are looking at blockchain as a mechanism for communicating and transacting as well so I think that's a big technology change," the panellist said. Leveraging investments, monetising data, reducing costs, doing things more efficiently, and allowing operations to be more automated, "I think it's the natural next stage," the expert concluded.

Another market expert said: "The next big thing for securities markets will be shortening settlement cycles, and obviously we've seen recent issues in the US with retail investors."

When it comes to retail investing, the panellist questioned whether the mainstream market should be stepping in to help new, smaller entrants reduce risk, such as through developing sponsored models to help connect counterparties, they added.

Another panellist thought the future will usher in technologies that improve efficiency due to the high capital costs of running a business. Efficiencies could be found through removing intraday liquidity charges through a blockchain for finality of settlement, they added. "I think what you are starting to see, and you're seeing it with one or two providers, is a lot more focus on that and how do we move securities or tokens around the system in a much more efficient way."

All aboard the Bund wagon

Yields on German Bunds have been negative since Q2 2019 but David Lewis of FIS says that a return to positive yields is on the cards due to a number of factors and influences, including a change in political management

"Asset values may fall." It's a common warning seen alongside many investment opportunities. "You may get back less than you invested," is another. These warnings are there to ensure a degree of buyer awareness should their investment not achieve the stellar rates of return the marketing materials offer. Those rates of return are never guaranteed, and there is a risk that those future predicted earnings may not match the (occasionally well chosen) prior period of performance. But how would such warnings describe a guarantee that you would lose money?

The government debt markets have been more than a little askew over recent years. Much has been written about the benefits and perils of quantitative easing, but as such fiscal support turns to the end of the cycle, the economies it has sought to support will have to find a way to do without it. Bunds, government debt issued by Germany, have long been one of the highest quality pieces of debt an investor could purchase, virtually guaranteeing their capital would be returned unharmed, if not enhanced a small amount. However, yields on Bunds have been negative since Q2 2019, averaging around -50 basis points (bp) since then but dipping as far as -90bp in March 2020.

Negative yields indicate that an investor, holding the asset to maturity, will receive less back on redemption than they spent to buy that security. This includes all income due on that asset, such as coupons. In essence, the demand for German Bunds has meant that investors have been queuing up to pay the German government to hold their money for them. It's a kind of extremely secure self-storage rental unit for your money.

There are, of course, many complicated factors at play here, including the quantitative easing policies of the European Central Bank (ECB), which continues to purchase bonds at an eye-watering rate, plus the increasing need for high-quality collateral in the wider financial markets. But the financial markets and the prices of the assets traded within them are always looking forward, attempting to predict what will happen. With the growing talk of the ECB beginning to taper off the bond purchase programme, together with the ongoing weaknesses in European economies striving to emerge from the COVID-19 pandemic, the unthinkable may be happening: Shorting Germany.

There is a multitude of reasons why investors may want to borrow government debt, especially Germany as a leading nation in the supposedly rock solid G7. However, it is somewhat hard to ignore the change in borrowing patterns since January 2020, the end of the pre-COVID era. Figure 1 shows borrowing volumes and costs for German government debt from 1 January 2020 to 13 May 2021.

January 2020 saw the volume of German government debt borrowed opening around the 12 billion bonds mark. The rebate rates charged over the year end dipped to around -75bp, rising to -50bp from 2 January as year-end influences abated. Borrowing volume decreased through the first half as the world began to respond to the growing pandemic, but, as the full impact of the situation became clearer, borrowing began to rise. As Figure 1 shows, the start of the second half of 2020 saw the start of a steady and almost inexorable rise in borrowing volume, from around 10 billion bonds to a recent peak of over 23.5 billion bonds at the end of March 2021, a rise of some 135 per cent. Over the same period, utilisation increased from 21 per cent to 37.5 per cent, a rise of 73 per cent which, at a little over half the increase in volume, would suggest growth in available supply in the market.

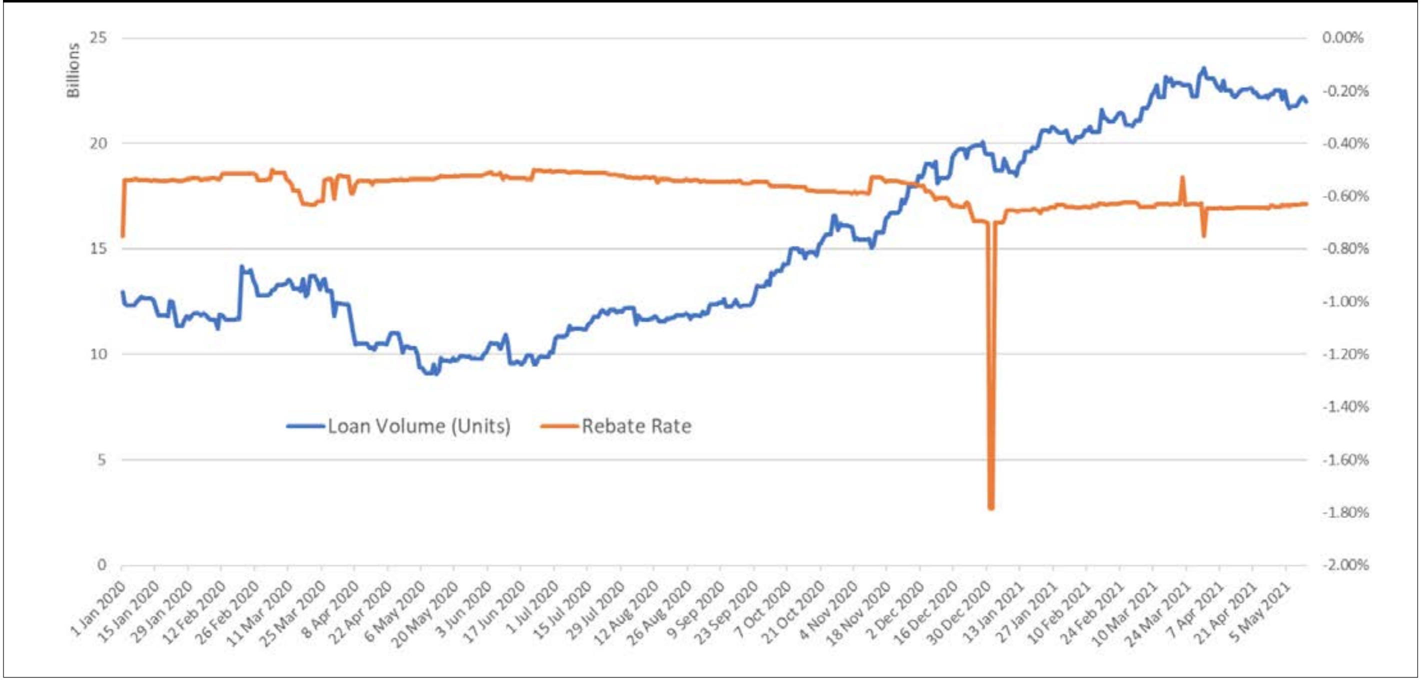
Year-end 2020 saw the usual scramble around borrowing and lending rates, but this time it showed a significantly higher impact, with rebates falling a full percentage point lower than the previous year, dipping at a new low around -178bp.

Peak volume at the end of Q1, 31 March 2021, also saw a dip in rebate rates to -75bp as shown in Figure 1.

Looking forward through 2021 and beyond, other influences are going to be putting pressure on German government yields, not least of which will be the potential change in political leadership after a prolonged period

Figure 1 *Source: FIS Astec Analytics*

German government debt borrowing volume and cost from January 2020 to May 2021



of certainty. Elections later this year may bring changes to Germany's traditional grip on fiscal policy, debt management and bond issuance. A change in political management in Germany will likely bring a potential loosening of the purse strings, increasing government debt and inflationary government spending across Germany. These factors, coupled with the pent-up spending from a European population emerging from over a year of lockdown, will bring inflation and estimates for consumer price growth in 2021 are growing. A return to positive yields is, therefore, on the cards. For yields to rise, asset prices must fall with the associated impacts a sell off in such debt will incur.

According to a global research paper by the Bank of America, the turn from negative to positive yields in the ten-year benchmark German bonds will mark the end of the bull run in corporate bonds. Some 15 per cent of respondents backed this as a turning point in the markets, which does not sound like much of a majority viewpoint when quoted in isolation. However, context is everything and this inflection point was second only in terms of bearish market indicators to the tapering of central bank support, something bullish markets have been relying on alongside the significant stimulus packages being rolled out by many governments.

Nothing is certain, of course, and central banks may back away from tapering plans if the economic shock is deemed too great alongside the issues the last year under lockdown have brought, but whatever happens, the warning notes to investors about the potential to lose their capital should be written in large font.

David Lewis
Senior vice president
FIS, Astec Analytics

Comings and goings at BNY Mellon, Pirum, Transcend, and more

Thomas Benevento has joined Transcend from PrimeOne, to head up the inventory, funding and liquidity solution provider's client management division.

Benevento brings more than 15 years of experience within capital markets, including managing hedge fund relationships in Deutsche Bank's prime brokerage and derivatives divisions. In 2015, he spent five years with fintech PrimeOne Solutions — subsequently acquired by IHS Markit — heading up business development and relationship management.

As head of relationship management, Benevento will utilise his extensive client-facing experience to help boost Transcend's global expansion and build and manage its customer relationships.

On his new role, Benevento says: "I am extremely excited to leverage my previous experience and build an effective Customer Success programme within Transcend. I look forward to creating a forum where our clients can openly provide feedback, share ideas, and view their engagement with Transcend as a partnership.

"Doing so will allow Transcend to proactively develop the innovative solutions our clients need most."

Transcend CEO Bimal Kadikar says: "Since inception, Transcend has been committed to fostering deep strategic partnerships with our clients focused on their success. As we expand our customer-base, it is critical to establish a global role that ensures our clients continue to receive exceptional customer service."

Laide Majiyagbe to head up BNY Mellon's financing and liquidity division

Laide Majiyagbe has been appointed head of financing and liquidity at BNY Mellon.

In this newly created position, Majiyagbe will take the reins of BNY Mellon's securities finance, liquidity services and collateral segregation businesses.

Majiyagbe joins the US banking investment company from Goldman Sachs, where she spent 14 years serving in a variety of positions within liquidity and collateral management, most notably playing a key role in the design of a number of its post-crisis collateral management and optimisation tools.

In addition, Majiyagbe worked closely with Goldman Sachs' prime brokerage business in collateral and liquidity management, providing her a considerable level of understanding of securities financing from both broker-dealer and consumer perspectives.

In her last role at the company, Majiyagbe served as Goldman Sachs' global head of liquidity projections in the firm's corporate treasury division. She will now oversee the strategic direction of BNY Mellon's financing, collateral and short-term liquidity offering.

Majiyagbe says: "This business is undergoing a transformation in order to create an open architecture that efficiently and seamlessly connects clients with the products and services they need to navigate complex capital markets.

"I'm proud that my wide-ranging experience across liquidity management, securities finance and collateral management enables me to make my own contribution to this ambitious agenda," adds Majiyagbe.

Robert Zekraus has joined Pirum as chief operating officer and head of the Americas.

Zekraus left Scotiabank for financial services technology vendor Pirum Systems and has been on gardening leave since February.

He vacated his position as managing director, global banking and markets, prime services at the Canadian multinational, a role he held in New York for six-and-a-half years.

In addition, Zekraus served on the bank's US board and on the board of directors at Scotia Capital in an advisory capacity.

Before Scotiabank, Zekraus worked for more than a decade at Barclays Investment Bank, in both New York and London. During his 15-year tenure at the banking giant, Zekraus was head of US securities lending and worked in the equity finance funding and financing sales division.

On his new role, Zekraus says: "I am looking forward to collaborating with my new colleagues and the leadership team at Pirum as we continue to help the securities finance industry transform itself through innovative and proprietary technology solutions.

"I'm eager to work with our clients helping them enhance processing efficiency, reduce operational risk, meet regulatory requirements, transform collateral and improve profitability. Pirum is uniquely positioned to advance in this space and I am excited about the prospects of building out the Americas business, which is key to our global growth strategy, in alignment with our future tech initiatives."

Pirum CEO Phil Morgan said at the time of Zekraus' announcement in February: "I am extremely excited to have attracted someone of Bob's calibre to the business and my management team. He brings with him significant experience in global markets, collateral management and financial technology.

Frank Kost has joined software-as-a-service (SaaS) provider LiquidityBook.

Kost will head up the sell-side business development, North America division of the SaaS-based provider of buy- and sell-side solutions in the company's New York office.

North America has the highest concentration of LiquidityBook clients and Kost will be responsible for bringing in new business in the region, promoting the firm's portfolio, order and execution and management system LBX Sell-Side.

Kost's most recent position was director of business development at Axos Clearing. Prior to that, Kost developed a keen understanding of the sell-side order management system space as a senior sales executive at fintech firm SS&C. Kost has also driven business development in senior sales roles at Aegis Capital, Bloomberg and Reuters.

LiquidityBook chief revenue officer Sean Sullivan says that despite a focus on global expansion in recent years, the firm recognises untapped potential in North America. "Adding Frank Kost to the team will help us expand our sell-side client base and identify new ways to cater to both clients and prospects.

"The pandemic has accelerated demand for multi-tenant, SaaS-based products like ours, while continued cost pressures mean that a transparent, broker-friendly business model for FIX connectivity is crucial."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