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Securities lending associations establish working group for global collaboration

Five trade associations representing the securities lending industry have established a working group to collaborate on priority issues in global lending.

This includes ESG integration and ongoing efforts to promote the benefits of regulated and transparent short-selling to liquid and sustainable capital markets.

The founding members of this working group are the Canadian Securities Lending Association (CASLA), the International Securities Lending Association (ISLA), the Pan Asia Securities Lending Association (PASLA), the Risk Management Association (RMA) and the South African Securities Lending Association (SASLA).

They indicate that all recognised securities lending associations, and other financial market associations with an interest in securities lending, are welcome to join the group, which will convene quarterly through virtual meetings.

The group first met in July and will build on the momentum generated in developing the Global Framework for ESG and Securities Lending (GFESL), which was published in May. It aims to foster a greater collaborative approach to issues relevant to global securities lending by sharing experience, insights and resources.

It will also provide a common front that will strengthen communication with financial regulators, financial infrastructure entities and standard-setting bodies worldwide.

One of its initial projects is to create a library of ESG resources that will bring together the work conducted by the individual member associations. It will develop ESG guidelines and thought leadership around stewardship, voting rights, collateral and transparency, taking into account that regulation of sustainable finance and market practice are at different stages in their evolution in different regions.

CASLA president Don D'Eramo says: "With the ongoing globalisation of the securities lending industry it is undeniable that there is a need for a harmonised approach to key themes which impact us all across the globe.

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CASLA is pleased to work in closer collaboration with our global partners as we tackle similar responsibilities, albeit with regional nuances for the advance and sustainability of our market and its shareholders."

ISLA CEO Andrew Dyson comments: "The work that we have already done together confirms that cross-association collaboration will be increasingly important as our members demand common solutions to global issues. The creation of this group provides an ideal platform to develop and reflect upon how we want to respond to these challenges and opportunities that resonate across all of our markets."

"Participants in the securities lending market have global reach and global priorities," says Paul Solway, PASLA director and communications officer. "The industry needs to work together to advance our shared priorities. We want to ensure that securities lending increases returns for lenders, supports liquidity and price discovery, and contributes to more sustainable financial markets."

"While our respective associations already cooperate in the service of our industry, coordinating in this way will expand the positive impact of our work regarding ESG, short selling and other global industry priorities," says RMA director of securities lending and market risk Fran Garritt.

"Although there is a growing demand from investors who recognise that ESG disclosure is vital for good investment decisions, there is no agreed international framework yet for SLB," says SASLA chairperson Michael Wright.

"SASLA hopes that the Global Framework for ESG and securities lending is a first step towards the convergence of existing metrics and standards. Markets do differ, but the underlying principles remain the same and hence collaboration is key to ensure a sustainable securities lending market in accordance with guiding best practices," says Wright.

State Street's Collateral+ now operational with Acadia

State Street's Collateral+ business is now operational with Acadia's Initial Margin Exposure Manager (IMEM) and Margin Manager (MM) services.

This integration provides automated dispute management for initial margin agreements and electronic margin call messaging across multiple products.

It will not only aid clients in complying with Uncleared Margin Rule (UMR) regulations, but also State Street's clients will avoid and resolve disputes for SIMM/Grid calculations and increase their operational efficiency by providing standard calculation, reconciliation and straight-through margin processes.

Staffan Ahlner, global head of Collateral+ for State Street, says: "With the pending final phases of the Uncleared Margin rules for over-the-counter (OTC) derivatives, an increasing number of our clients are looking to replace manual processes with new tools that focus on workflow automation.

"By maximising low touch operational processes and speedy resolution of disputes, we continue to focus on 'enabling the trade' for current and future clients."

Matrix Applications launch DV Securities on QTIX platform

Matrix Applications, a New York-based finance technology service bureau, announces the launch of DV Securities onto its QTIX platform.

The platform is a securities finance solution for brokers, dealers, asset managers and banks in fixed income capital markets. It is engineered to deliver exceptional performance for organisations, with functions including front-office trade entry, settlement and clearance, reporting and accounting.

Eric Carlino, executive vice president of fixed income at DV Securities, says: "We executed our first trades as a Tier-1 netting member of FICC's Government Securities Division (GSD). Throughout the lengthy regulatory and clearing bank approval processes, the staff at Matrix Applications showed their professionalism, personal attention and focus on helping DV Securities achieve this milestone."

Stephen Mellert, managing director for Matrix Applications, adds: "DV is able to achieve straight-through-processing from brokers down to DV's clearing agent and GSD account at FICC. And the managed services team lets DV focus on what they do best, trading."

Columbo exchange launches repo platform for corporate bonds

The Columbo Stock Exchange (CSE) has introduced an over-the-counter (OTC) trading platform to support repo transactions on corporate debt securities.

The Sri Lankan exchange indicates that this new service will complement trading services provided for corporate bonds on its automated trading system (ATS) platform and aims to improve liquidity in corporate debt markets.

"Considering the large volumes of fixed income securities actively traded by market participants outside the CSE's platforms, the CSE observed the opportunity to play a role as a facilitator in connecting securities

providers with collateral who need to finance their liquidity requirements with cash providers," says the exchange.

The OTC platform provides a matching facility, ensuring counterparty trade instructions are aligned prior to execution of the repo transaction, as well as supporting collateral replacement and rollovers.

On launch, the OTC platform will support only repo transactions conducted against CSE-listed corporate debt securities. In consultation with market participants, CSE will review opportunities for extending the range of securities that may be financed on the platform as the service evolves.

The Securities and Exchange Commission of Sri Lanka, the securities market regulator, has approved necessary changes to trading rules and master repurchase agreements prior to the platform going live on 16 September.

Banco BICE strengthens Calypso investment and use of Adenza technology

Adenza, the company formed by the merger of Calypso Technology and AxiomSL, announces that Banco BICE has strengthened its investment in the firm's Calypso platform and extended its implementation of Adenza Technology.

In 2018, Chilean bank Banco BICE launched a project to replace incumbent technology for its capital markets business with a new cross-asset platform.

With the first phase of this project completed, including the implementation of Adenza's Calypso collateral management and clearing solution, Banco BICE will focus on expanding its transformation programme to front-to-back, cross asset trading and risk management.

Marcelo Espinoza, treasury director at Banco BICE, adds: "We are excited about the Adenza's Calypso implementation process since it will allow us to address a front-to-back business solution. It is a technology we can rely on to deliver more efficient, highly developed, and better-quality products for our clients."

Luis Gustavo Penteado, Adenza's head of sales for South America, says: "Despite the uncertainty caused by COVID-19, it is encouraging to see Banco BICE continuing to make long-term investments. Latin America is a strategic market for Adenza, with a number of new client signings recently confirming our strong positioning.

"We now operate through three offices in the region where we continue to invest to provide leading global solutions adapted to local market conditions and conventions."

Moscow Exchange to accept international stocks as collateral

National Clearing Centre (NCC), part of the Moscow Exchange Group, will accept securities of international companies as collateral for trades made on Moscow Exchange markets.

The move will allow professional market participants and their clients more flexibility in funding their operations on MOEX and will help facilitate their trading activity.

The firm has listed 18 international stocks including Microsoft Corporation, Cisco Systems and Intel Corporation, that will be accepted as collateral, with the list set to expand in the future.

Earlier this month, NCC was granted the status of Qualified Derivatives Dealer (QDD) by the United States Internal Revenue Service (IRS). This status allows Moscow Exchange to facilitate trading in US securities for banks and brokers, as well as on the Money Market.

Professional traders will be able to make better use of the margin trading mechanism on MOEX's equity market for their retail clients.

Global PSSL publish consultation paper on ESG-driven SBL

Global Principles for Sustainable Securities Lending (Global PSSL) have published a consultation paper on ESG-driven securities lending and borrowing in emerging markets.

The draft hinges upon three components that relate to enabling market infrastructure, ensuring appropriate tax schemes and strengthening supportive legal foundations in various emerging markets.

To employ this standard, participating organisations will need to observe the central tenets of Global PSSL — as well as relevant regional ESG agendas — and demonstrate an active engagement with stakeholders, according to Global PSSL.

With an objective to be forward-looking, universal, fit for purpose and dynamic, the paper listed a number of challenges to delivering these aims, including a limited awareness of ESG, the stigma associated with certain aspects of securities lending and the limited participation of beneficial owners in securities lending programmes.

The draft was co-authored by International Finance Corporation's (IFC) Oluwatoyin Alake, Stanbic IBTC's Babatunde Majiyagbe, Global PSSL and University of Exeter Law School's Dr Radek Stech, the South African Securities Lending Association's (SASLA) Juanita Taylor, SASLA's Jean Turner, and Global PSSL College of Advisors' Roy Zimmerhansl.

The co-authors say: "When compared with more developed economies, the inherent flexibility of emerging markets grants them the agility necessary to adopt best practices. As this draft standard has identified, fragmentation is one of the barriers that increases costs and inhibits innovation.

"Global PSSL brings a broader community of practitioners, also ESG experts, and, in turn, increases trust and confidence in the markets".

The consultation will end on 15 November 2021.

Fund Recs automates connectivity with DTCC's GTR service

The Depository Trust & Clearing Corporation (DTCC) has partnered with Fund Recs to deliver new automated reconciliation capabilities in support of the European Market Infrastructure Regulation (EMIR) and the Securities Financing Transactions Regulation (SFTR) trade reporting requirements.

Fund Recs' Velocity service, a no-code, cloud-based platform that automates reconciliation for the investment management industry, will connect to


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DTCC's Global Trade Repository (GTR) service.

This will retrieve and analyse trade data for accuracy and completion, simplifying and streamlining the reconciliation process, explains Fund Recs.

Under EMIR and SFTR, fund managers are required to submit their transaction data to a trade repository in a timely manner. Oversight of this transaction data is critical to ensure data quality and adherence to the mandates.

By leveraging Fund Recs' Velocity service and DTCC's GTR, fund managers can compare and match trade records submitted to the GTR service with their internal accounting book of record.

By doing this, Fund Recs says fund managers can ensure that trades have been submitted and are complete as defined by the European Securities and Markets Authority trade reporting requirements.

Additionally, the new connectivity allows Velocity to automatically retrieve clients' trade data from GTR, facilitating timely, efficient, and straight through data quality control, eliminating manual processes.

Alan Meaney, CEO of Fund Recs, comments: "Fund managers are under increasing pressure to ensure EMIR and SFTR reporting is timely, accurate and complete. Our reconciliation modules provide a streamlined, fully auditable, and automated solution for managers, which helps to ensure their governance needs are met."

Meaney says: "We are delighted to be collaborating with DTCC as entering into this agreement enables us to increase the level of automation we provide to our clients."

Chris Childs, managing director and head of repository and derivatives services, adds: "DTCC is committed to helping establish a robust, comprehensive reporting infrastructure for the global derivatives market.

"We welcome the opportunity to work with innovative third-party service providers like Fund Recs to build connectivity to our repository services and help our mutual clients meet regulatory mandates in Europe and beyond."

DTCC's Project Ion advances into development phase

The Depository Trust & Clearing Corporation's (DTCC) Project Ion initiative is set to move into a development phase following a successful prototype pilot with market participant firms.

Project Ion is an alternative settlement platform that leverages distributed ledger technology (DLT). It is specifically modelled around a netted T+0 settlement cycle, but it is also capable of supporting T+2, T+1, T+0 or other extended settlement cycles.

The platform is designed to provide a clearance and settlement option for the industry leveraging DTCC's core benefits of risk management and volume capacity, including netting and the trade guarantee of the central counterparty (CCP).

As well as this, it has been designed to support new features with interoperability between the Project Ion platform and the classic settlement platforms at The Depository Trust Company (DTC), and to ensure adherence to DTCC's regulatory standards across resiliency, stability, security, risk, and controls.

Project Ion's functionality will be introduced in phases. The first phase of the Project Ion platform will support bilateral deliver order transactions that will be initiated by pilot participants through client nodes hosted by DTCC.

Once launched, the transactions will be

processed through the Project Ion platform and then passed to DTC's existing systems for settlement processing, DTCC explains.

Future phases of Project Ion are expected to extend the platform's functionality over time to realise the reconciliation efficiencies offered by DLT. Other phases are anticipated to include the provision of access through a client-hosted node and expanding the transaction types processed by the platform.

Meanwhile, DTCC has planned for early and later adoption of the functionality and technology offered by Project Ion, to ensure the phased roll-out is responsive to clients' individual development agendas.

For clients, this means that while the general industry can move ahead to achieve T+1 accelerated settlement on DTCC's classic systems, those clients ready to integrate onto the ledger can begin development efforts and start to ready their firms for the future operating model without waiting for full-market adoption.

According to Michele Hillery, general manager of equity clearing and DTC settlement service at DTCC, the industry's primary goal must be to create efficiencies without introducing additional risk to markets, and client participation and feedback at every iterative step of this journey will be pivotal to the continued success of the platform.

Hillery says: "Project Ion holds the promise of new settlement functionality supported by robust technical capabilities and is a key part of our ongoing efforts to further accelerate settlement and build upon current same-day settlement capabilities."

Murray Pozmanter, head of clearing agency services and global business operations at DTCC, comments: "Project Ion has demonstrated that settlement in a T+1 or T+0 environment are effective use cases for DLT, and we look forward to working with our clients and the industry to launch the new platform."

ICMA's ERCC publishes preliminary findings of green repo consultation

The International Capital Markets Association (ICMA's) European Repo and Collateral Council (ERCC) has released a summary report on the role of repo in green and sustainable finance.

This publishes preliminary findings of an ICMA consultation process, which was launched on 22 April 2021 with the release of an ICMA consultation paper and extended until 4 June 2021.

The trade association intends that this should serve as a starting point for promoting broader debate in the repo community around sustainability issues and steps to explore existing opportunities and potential risks in this area.

The paper examined three potential areas of intersection between the repo market and sustainable finance objectives: repo with green and sustainable collateral; repo with green and sustainable cash proceeds; and repo between green and sustainable counterparties.

The summary report is based on 20 responses submitted during the consultation period, representing the views of 18 firms. However, the ICMA says that discussion on the topic is ongoing and further feedback on these questions is still welcome.

Asked which of the three intersections between repo and sustainability (outlined above) are most relevant to respondent firms, 62 per cent said that 'green collateral repo' is most relevant to them and "that it is the most straightforward concept to implement".

Asked whether there are other possible intersections between the repo market and sustainable finance that are not addressed in the paper, four respondents highlighted the idea of sustainability-linked repo, where counterparties need to fulfil certain environmental, social and governance (ESG) key performance indicators (KPIs) or sustainability performance targets to access cheaper cash (ie pay lower interest).

Other respondents highlighted the use of other green, social, sustainability and sustainability-linked debt instruments (GSSS) beyond bonds, including loans, trade finance and letters of credit.

The consultation process identified potential demand for green collateral swaps, where one party receives high-rated liquid non-GSSS collateral and transfers GSSS collateral to the counterparty for a fee.

Respondents also identified value in creating mixed collateral baskets or pools, which may be a mix of different underlying GSSS collateral, or a basket of GSSS collateral mixed with a small amount of non-GSSS collateral.

Reflecting on where they identified greatest potential risks to their firms linked to a green and sustainable repo market, 59 per cent of respondents identified 'greenwashing' as being their top concern.

Specifically, they associated greenwashing with the risks associated with incorrect classification of products as 'green' investment, or 'double counting' of green collateral repo, where no additional green assets are created through the transaction and no additional funding goes into green activities but both counterparties claim the green collateral as a commitment to green investment.

Responding to this point, a number of respondents underlined the importance of maintaining a clear methodology to ensure that green investments are only counted once. For example, they should only be considered for the sustainability metrics of one of the parties to the repo transaction.

Beyond greenwashing, respondents highlighted the need for clear procedures to ensure that collateral eligibility criteria are applied throughout the lifecycle of the repo transaction — and that the ESG quality of collateral is not compromised through collateral substitution that replaces 'green' assets by 'brown' assets for example.

Other respondents indicated that collateral quality is a potential risk as "green does not necessarily mean better credit".

In providing guidance on what the ICMA's role should be in developing a green and sustainable repo market, the most-popular response was that the association should provide clear definitions and standardised approaches for different types of 'green repo', potentially through a specific framework similar to the ICMA's Green and Social Bond Principles.

The consultation also indicated that the ICMA should continue with its regulatory engagement in developing the foundations for a green repo market, as well as encouraging debate and working with other trade associations and market bodies.

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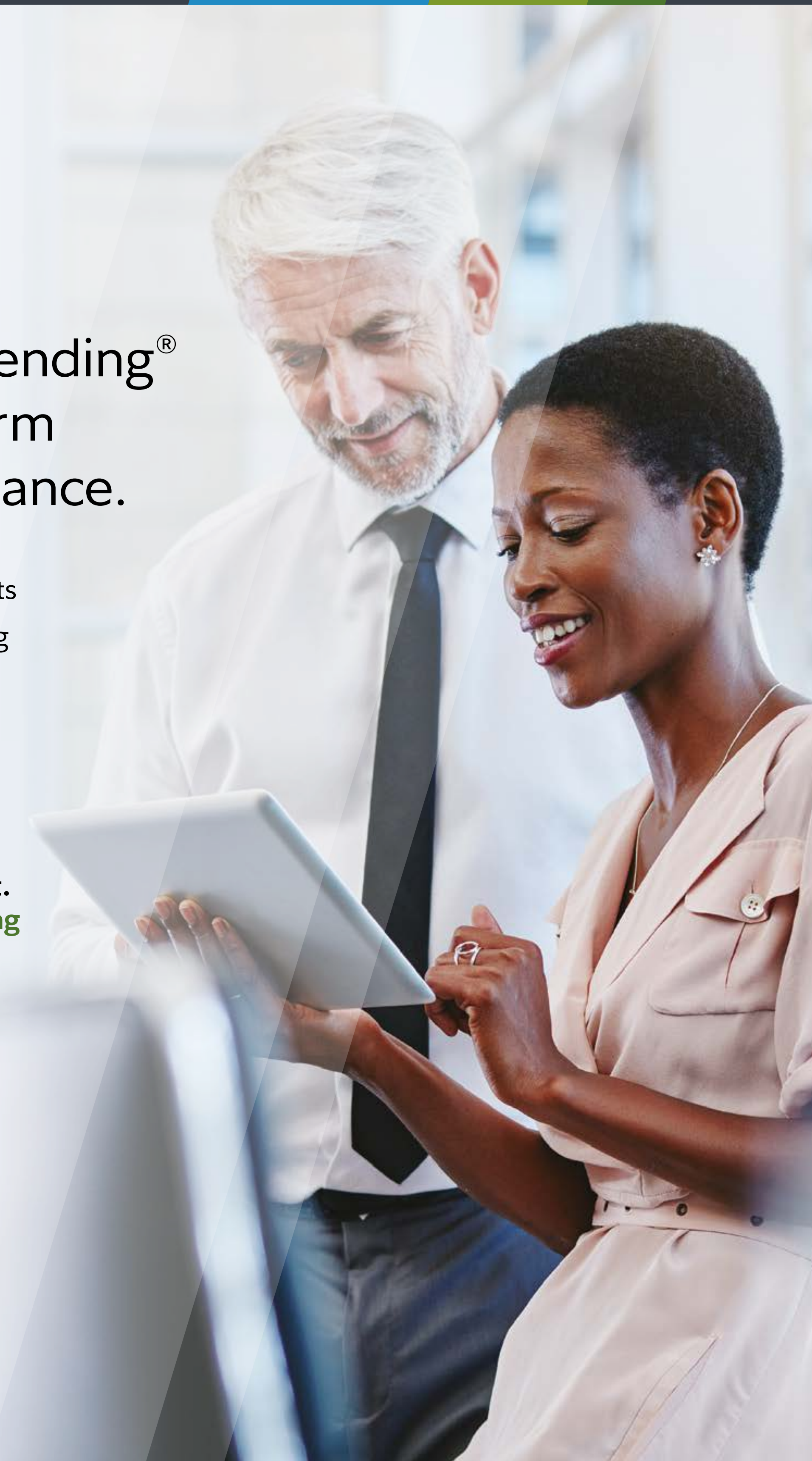


GLMX: applying technology gains to liquidity access

Bob Currie reports

GLMX's chief operating officer Sal Giglio tells SFT that the 3–5-year path for financing and other money markets will be driven by the convergence of liquidity and technology

The past 24 months has brought major liquidity pressures, with the Q4 2019 repo spike followed by the impact of COVID-19 from Q1 2020. Then it brought massive liquidity injections from central banks. How has GLMX helped the market manage these liquidity demands through its trading platform and repo technology?

The liquidity spikes which occurred in the fall of 2019 and the spring of 2020, while disruptive to both primary and secondary securities markets, are explicable and not outsized in the context of the history of systemic liquidity management of the last three decades.

It is uncontroversial to say that deep, orderly and accessible financing markets are the cornerstone upon which the capital markets are built. Traders, treasurers, issuers, liquidity managers — both private and public — and regulators need daily access to the markets to complete their essential tasks and to keep supply and demand in balance. Historically, the Federal Reserve managed excess reserves to an accuracy of billions to tens of billions of US dollars. In today's era of "ample reserve management", excess reserves total in the trillions – above US$3 trillion during 2020.

One of the impacts of such significant excess reserves is that, on most days, with all that liquidity in the system, nobody thinks much about its availability as reserve liquidity is in dramatic excess to system demands. On those days in 2019 and 2020 there were external shocks to the system – tax-related liquidity demands on top of US Treasury auction settlement in 2019 and fear-based liquidity hoarding due to the COVID-19 pandemic explosion in March of 2020.

On top of those variables, the Fed's longstanding, intra-day liquidity addition tools were long out of practice and regulatory changes made it difficult for liquidity to move from those who had it, mostly banks in their Fed accounts, to those who needed it – primarily securities companies, even many with large bank owners. Unsurprisingly, the result was higher financing yields. While GLMX harbours no illusions about telling the Fed how to implement its monetary policy, we can help to maximise market participant access to liquidity pools in situations such as those above. GLMX technology maximises liquidity location, negotiation, execution and straight-through processing in near real-time, helping market participants to identify and manage their funding needs much more quickly than if they communicated via chat, email or voice and booked trades manually.

Thus, managing the full trade flow, from inquiry initiation, negotiation, execution to straight-through processing, not just part of this process, is essential for clients to improve their funding not only in times of stress but as a matter of business as usual. An added benefit of the digitisation of securities finance execution during the COVID-19 pandemic was the enabling of "virtual trading floors" in a work-from-home environment, in which GLMX technology afforded traders, liquidity managers and risk managers the ability to monitor and execute liquidity needs in near real-time.

What lessons have you learnt during this time as a specialist provider of repo tech?

In the early days, as GLMX set on the journey to digitise the manual workflow around securities finance, we regularly ran into the argument that "this market, while admittedly inefficient and largely manual, has worked fine for many years and therefore needs no efficiency improvement". GLMX's view was that enhanced access and efficiency in a market as critical to the overall financial system as repo would benefit everyone involved, especially in the environment of global zero interest rates.

In those early days, we leaned heavily on the encouragement and market support of "early adopters" that shared our vision. The fact that GLMX has been, to date, a specialist in repo has been quite motivating. At GLMX, we often say, at this point with a smile, that we had no other market to fall back on. Either we became successful with repo or we failed. We also learned, especially in a world with historically low interest rates, that cost matters. As such, we have used the advantages of a super modern technology stack to minimise the cost of our technology solution. Combined, these forces have enabled us to provide a world-class technology ecosystem while maximising value pricing.

GLMX's long standing ambition in the funding markets is not to change what is being done, but how it is being done. What are your next priorities? In which direction are your clients taking you?

That's an accurate assessment and a great question. GLMX's top priority has been — and continues to be — to provide a comprehensive, cost-efficient technology solution for the securities finance markets and to provide best-in-class client support. The continuous feedback we receive from our clients is that we are succeeding in doing so every day and that our reputation for excellence is driving new clients in our direction. That said, a common theme which we hear from our clients is that they would like to extend GLMX's technology and client responsiveness to adjacent money markets.

Having said that, at GLMX we fully appreciate the dangers of broadening our product set too quickly and without significant and active client support. We recognise that each instrument within the global money markets is its own micro-ecosystem with its own unique challenges. To serve those markets as well as we do in the repo space, it is imperative that we identify the critical pain points and efficiency enhancers that will maximise adoption and value for our current and prospective clients. One market which met those criteria, and which we have actively engaged both from a technology and client perspective, is the fixed income securities lending space.

Securities lending is a very close cousin of repo and our technology naturally extends to that market. GLMX's approach has been to identify early adopters – which is exceptionally challenging in itself – and to use their initial feedback to build essential functionality for their market needs. We then iterate to perfect our technology to provide comprehensive functionality and maximum value to those clients. This process has been ongoing for more than two years at GLMX and we are well advanced in the process with most major securities lenders.

GLMX first came to market in 2010, not long after the global financial crisis had prompted root and branch review of funding markets. As a specialist in liquidity-seeking technology solutions, how do you see funding markets changing over the coming 3-5 years?

Saying that GLMX "came to market in 2010" certainly would elicit some rolled eyes among our founders. What GLMX really did from 2010 to about 2014 was to learn how NOT to build technology for repo and other money markets! In seriousness, that often-frustrating process of identifying what it takes for clients to adopt technologies was instrumental in making GLMX what it is today.

As mentioned above, the prime directive for our clients all along has always been liquidity, liquidity, liquidity. In today's challenging market environment, efficient access to liquidity is paramount. Given regulatory, interest rate and COVID-related challenges, market participants have opened their minds to new evolutions in securities finance markets. At GLMX, we strive to execute for the present while building technology capable of serving a future where numerous outcomes are possible.

At GLMX, we believe that the most likely 3–5-year path for financing and other money markets is the convergence of liquidity and technology. What such a notion means to us is that market participants will increasingly see, negotiate, execute, process and analyse liquidity solutions across an array of global short-term markets. The only way to realise that future is through integrated and highly flexible technology, which maximises access to liquidity and to data which support liquidity-related decision making. Whether across geographic regions, across individual funding instruments, across cleared or non-cleared alternatives or across cash and digital assets, market participants increasingly will be drawn to the massive liquidity available in integrated markets.

What does GLMX's technology strategy look like for the next 3-5 years? How are you applying innovation to enhance the matching, workflow, connectivity, and reporting tools that you offer for repo transactions?

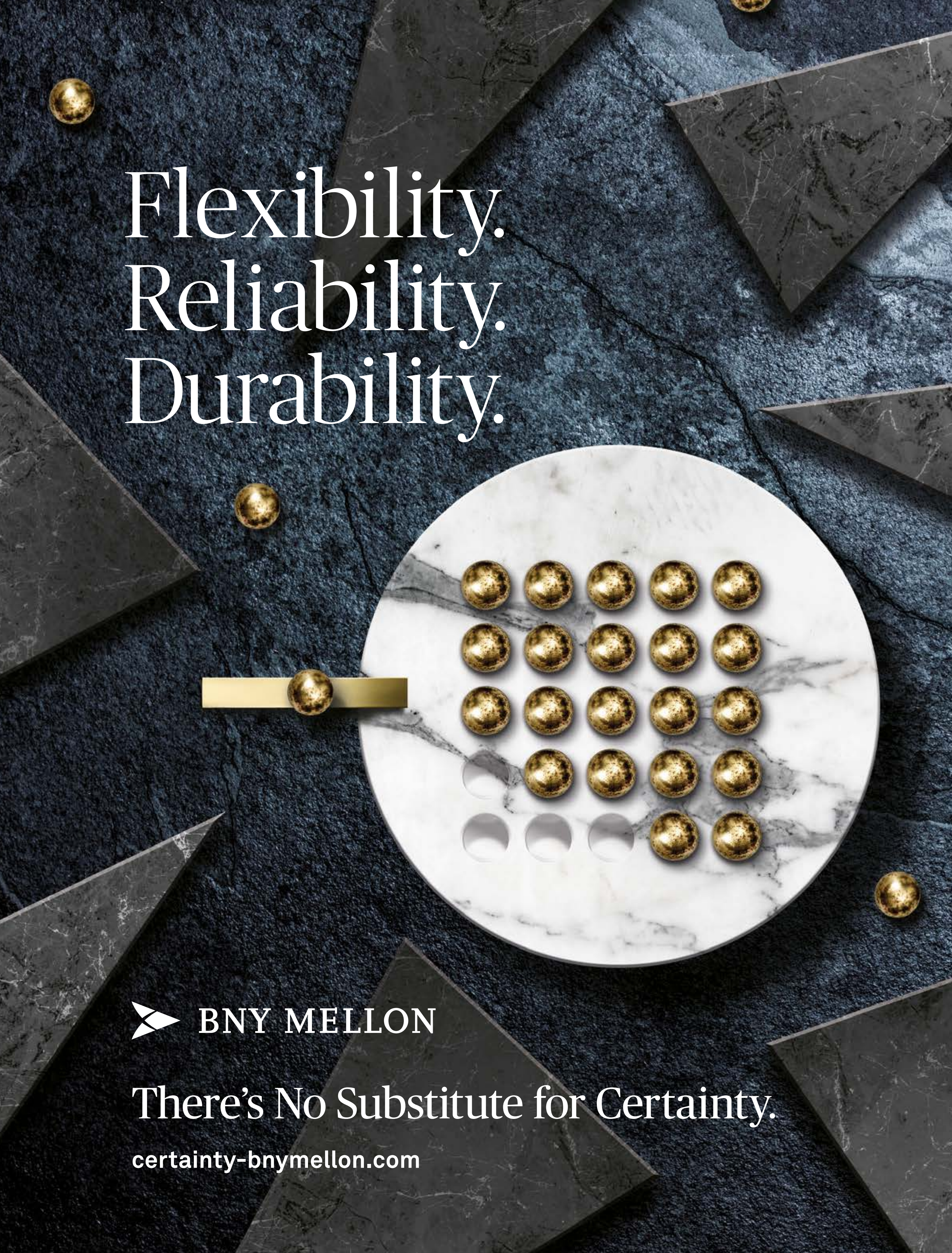
Three pillars which differentiate GLMX are: first, ultra-modern, flexible, customisable and intuitive technology; second, expert industry-experienced employees; and, third and most importantly, a deep and broad network of buy-side, sell-side, technology vendors and large industry utilities which have grown over several decades. We are very clear that no market consists of a single participant. By their nature, markets are at their best with a broad and diverse group of participants. The same is true of technology. While GLMX values its independence, as it allows us to maximise focus and to serve all clients equally, we fully appreciate that a growing, interconnected network of partners is integral to our clients and therefore, to GLMX's success.

This approach to business is already clearly evident in our connections to numerous mid and back-office systems and clearing mechanisms, all to the mutual benefit of those partners and, ultimately, to our mutual clients. GLMX technology is designed to manage all types of global entities, is agnostic to trade settlement (delivery-versus-payment, tri-party, cleared, DLT), and can send trade information to multiple venues at once (for example, trading firms, tri-party agents, custodians, prime brokers, third-party technology vendors and trade repositories). We believe that such interconnectivity is the key to the future we envision.

By way of identifying some GLMX innovations specific to the securities finance market, low-touch trading and automated execution continue to evolve with several clients already doing so. The allure of such capabilities is their ability to streamline client response times, pricing and trade execution which, when combined with straight-through processing, reduce position management risk and trading errors.

Another area, still in its infancy but with interesting potential, is digital ledger technology — specifically how smart contracts can be used to capture the comprehensive characteristics of securities finance transactions which include not only trade terms but legal agreements, settlement locations, delivery instructions and more. Again, we are actively exploring partnerships with leading DLT innovators to the mutual benefit of our mutual clients.

At GLMX, we have always emphasised, over everything else, the need to understand our clients' needs and translate the promise of new technologies to real-world solutions which maximise client outcomes. That is our past and our future.



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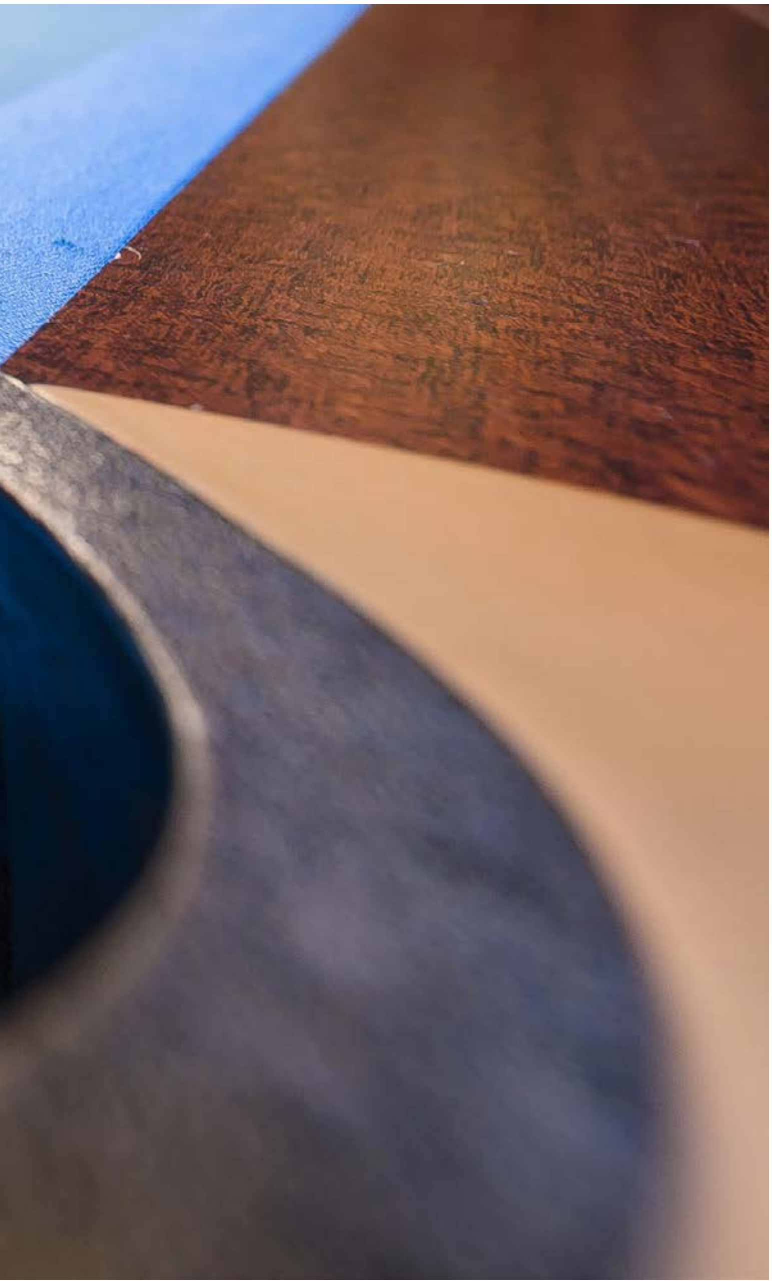
US Securities Lending: Tapping into Pockets of Opportunity

US lending specialists draw lessons from COVID and the GameStop short squeeze, discuss the demands of sustainable lending and highlight where lenders can drill into new opportunities moving into 2022



Panellists

Justin Aldridge
Senior vice president, head of agency lending
Fidelity Investments

Mark Coker
Head of North America equity agency trading, securities finance
Northern Trust

George Rennick
Head of agency securities finance – Americas and global head of client relationship management in agency securities finance, J.P. Morgan

Vikas Nigam
Director, Head of Agency Securities Lending for the Americas
Deutsche Bank

Tom Ryan
Head of asset-liability trading, global securities lending solutions group
Mitsubishi UFJ Trust & Banking Corporation

Martin Tell
Senior managing director, global head of securities finance, State Street Global Markets

How do you assess the performance of US securities lending markets during 2021 to date? What trends have you noted in terms of loan balances and lending fees? What have been the high earners — and the weak performers?

Justin Aldridge: The year began with one of the largest and highest-impact short squeezes the markets have seen. This had a wide-ranging effect, causing muted demand for fundamental single-stock shorting as short sellers retrenched to strategise about the new dynamic of crowd trading, with investors targeting companies with high short interest.

IPOs and special-purpose acquisition company (SPAC) IPOs have been key market drivers as well. Special situation opportunities like mergers and tenders have been down this year, compared to previous years, resulting in a negative impact on lenders' overall earnings, but there are a few large opportunities on the calendar for

Q4 of this year. We have seen strong demand for US fixed income issues and clients have been able to realise significant revenues on multiple “on the run” issues. The markets have been resilient and earnings appear to be on target overall to match or slightly exceed last year’s North American totals.

Mark Coker: US equity securities lending balances have risen through 2021, predominantly due to mark-to-market adjustments as equity markets continued to rally. This market dynamic, supported by Fed stimulus and lower interest rates, has resulted in a softer specials space. The rise of retail trading groups has also added borrower caution on highly shorted securities. High earners have generally come from new issuances (IPO/SPACs) or the exchanged-traded fund (ETF) sector.

Strong performance in the US fixed income securities lending space has come with the flight to quality and renewed demand for high-quality liquid assets. Loan balances increased in 2021 relative to the previous year, in part due to the abundance of US dollar cash in the market. We have seen a general increase in lending spreads, driven in large part by lower rebate rates on loans versus cash collateral and demand for benchmark securities.

George Rennick: On a year-over-year comparative basis, 2021 is underperforming 2020, mostly due to an abundance of US dollar cash in the financial system, spread compression and a lack of specials. Loan balances have increased across all asset classes, but relatively speaking fees have been compressed, with the exception of a handful of specific securities. SPACs, ETFs and specific IPO and deal-name securities have offered high returns. Cash re-investment yields and general collateral securities have been challenged.

Vikas Nigam: 2021 has been another interesting year from a securities lending perspective. Though not quite as dramatic as the 30 per cent plus stock market drop of Q1 2020 and subsequent recovery, early 2021 saw securities lending make mainstream news headlines as hedge funds were caught in massive short squeezes in popular meme stocks like Gamestop and AMC – all the while allowing clients holding these securities to enjoy bumper revenue.

As with 2020, Q2 onwards has been a different story. With stock markets continuing to rise and an ever increasing amount of cash being made available at the short end, spreads have continued to be squeezed at both ends, with revenue only being up year-on-year from increased balances derived from higher valuations and increased high-quality liquid asset (HQLA) activity. With a number of state treasurers and public pension plans as clients, we have also seen the effects of the American rescue plan, with billions of dollars added to lendable assets. We anticipate this will be repeated if the infrastructure bill is passed.

From the broker-dealer perspective, we have seen shifts in borrowing and funding needs to mirror the reflation trade (go long equities and short fixed income), with broker-dealers taking advantage of excess demand for their business to address regulatory requirements like extending duration and shifting balances to net stable funding ratio (NSFR)-friendly clients.

Martin Tell: Overall, as always, there have been bright spots and challenges. Two challenges I would note were: the contraction of specials trading after the GameStop and Reddit stocks’ short squeezes as short sellers de-risked and assessed their positioning to deal with both a new and determined equity investor base; and renewed interest in oversight of short sellers and other market participants.

The continued low-rate environment is also a challenge for fixed income lending as well as cash reinvestment. The bright side has been that, despite a period of de-levering, there has been a resurgence of directional specials activity in IPOs, SPACs and, as a general statement, small cap securities have garnered good interest from borrowers through the summer.

Which regulatory projects will have the greatest impact on your lending programme over the 12 months ahead? What adaptation challenges will these present?

Rennick: Over the next 12 months, certain European based regulations such as the Central Securities Depository Regulation (“CSDR”) will garner focus and support. Adherence to global banking capital rules will also have maximum impact as entities remain focused on balance sheet management and optimisation.

Coker: The most poignant of topics is CSDR, which introduces new measures for the authorisation and supervision of EU Central Security Depositories (CSDs) and sets out to create a common set of prudential, organisational, and conduct of business standards at a European level. CSDR applies to all European CSDs and to all market operators in the context of securities settlement — which will need to directly comply

with the measures the regulation introduces related to mandatory buy-in regime and cash penalties for settlement failures. Therefore, the scope of the regulation also includes, and impacts, US and Canadian clients and borrowers that trade European securities (equities and fixed income). It will be particularly important for agent lenders to have strong operational foundations, such as those present at Northern Trust with our global custody business coupled with a robust procedural control ecosystem to successfully navigate CSDR penalty regimes.

Tell: Speaking specifically for the US, we continue to digest changes that have occurred over the past few years as proposed regulation becomes law. For our institution, like all banks, these changes will increase the financial resource burden of most types of financing activity. The shared challenge is to become increasingly efficient with those resources, which may include further access to CCPs, alterations to how indemnification is applied, growth of facilitated peer-to-peer transactions and use of new technologies to both strengthen and grow our programme into the future.

The Q4 19 repo spike in the US was followed in early 2020 by the COVID-19 crisis. How did the market react? What lessons (if any) did you learn from this period that you will carry forward?

Rennick: During the repo spike of 2019 and the initial US lockdown period of the COVID-19 crisis (March 2020), the markets encountered an acute drain on liquidity as US dollar cash was hoarded and excess cash was trapped. In securities lending, liquidity buffers muted impact but raising necessary cash was expensive. The traditional lending and borrowing of securities functioned normally, with a higher percentage of securities on loan being collateralised with non-cash collateral. Cash collateral yields fluctuated throughout the two events, but opportunities did exist, especially with the volatility in rates. However, as an agent, it was important to ensure that cash reinvestment trading was commensurate with individual client risk tolerances and, in most cases, conservative portfolio management was the desired approach.

Tom Ryan: Both events spurred volatility, not just in the securities lending arena but in the broader markets as a whole. Therefore, as our team dealt with the implications of the disruptions, our beneficial owners were also dealing with their own situations. As such, the impact to revenue generation was less important to any risks and exposures, with both incidents leading to refresher courses on safeguards inside their securities lending programmes, counterparty credit quality, and the finer points regarding indemnifications.

In the aftermath of the Q4 19 repo spike and the reduction of the Federal Reserve reducing rates, from a range of 1.50 – 1.75 per cent to near zero in under two weeks, market participants were reminded that interest rate gap (i.e. mismatch) risk was something to be mindful of. The previous years had witnessed rate movements, both up and down, but in small increments of 25 basis points and generally signalled clearly in advance. As a programme, we clearly understand that securities lending will not always be at the top of a client's priority list during a crisis period and that it is up to us to steer them through all market conditions.

On the other hand, amid these challenges lay opportunities for agent lenders to assist beneficial owners with regard to their overall liquidity profiles. With equity markets in dramatic decline and other internal liquidity pressures at hand, some beneficial owners were reminded that, in consultation with their agent lender, they could draw on their securities lending collateral pool. Clients with this construct written into their contracts would have been further advanced along the learning curve and in a better position to employ that option. Any beneficial owner that had this conversation with their agent lender — or conversations regarding perceived or actual risks inherent in their securities lending programme — came out of the March 2020 market turmoil stronger than they went into it.

As the effects of COVID-19 began to take hold, it was clear that certain industries were going to be dramatically affected. These industries were encapsulated in an acronym fancifully named BEACH, which stands for Booking, Entertainment, Airlines, Cruises, and Hotels. Although at some points it looked as though some constituents of these categories would be unable to survive the pandemic, the reversal of their situations, and subsequent stock and bond prices, mirrored the broader market, albeit in a typically lagging fashion. Securities lending spreads and associated revenues for these categories followed suit.

Aldridge: Fortunately, neither event had a negative impact on our securities lending agency programme. Fidelity was well positioned to take on additional business, given our highly automated trading platform, our clients' conservative investment strategies and our ability to stay the course through volatility. It was business as usual and, in fact, Fidelity's securities lending programme benefited from the dislocation. Our on-loan cash balances increased significantly during this time.

Coker: The repo spike in late 2019, and the Federal Reserve response to the COVID crisis in March and April of 2020, both relate to the same market function – the level of excess reserves. What was a deficit of reserves in 2019, which increased rates, now dominates the story line as a surplus of reserves which is depressing yields.

Demand in fixed income was characterised by a flight-to-quality bid, with market participants looking to source HQLA, particularly in term maturity exposures versus lower-rated or less-liquid collateral. In the credit space, initial demand for corporate bonds was correlated with those industries most exposed to the COVID-19 impact such as leisure, travel, retail, and autos. Markets quickly calmed through the second quarter, with central bank actions providing comfort to market participants to re-engage across markets and trade structures.

Several hedge funds lost substantial sums on GameStop and other meme stocks in the early part of 2021 as retail investors battled with hedge funds that held short-interest positions in those securities. Some agent lenders indicated that this short squeeze triggered de-leveraging as hedge funds sold off long positions to cover losses and closed out shorts owing to contagion fears.

How (if at all) will these events change behaviour in US lending markets?

Tell: The challenge it presented was one that, frankly, we think we were well prepared for — and that is one of strong risk management. Market volatility caused by these events can have an impact on client lending appetite, counterparty and collateral exposures, and impacts on lending returns in terms of revenue. A zero-rate environment is challenging for client reinvestment. I would not say it is illiquid — we have no issues locating product to invest in, but with low rates and a flat yield curve the economics of general collateral trading change. We adjust our loan pricing and overall volumes of general collateral to ensure that we generate a return on those loans that are aligned with our clients' expectations.

Generally speaking, the only impact was to revenue as specials trading contracted and demand decreased. Clients certainly wanted to speak about the topic, as it was a headline item each day, but we didn't see any behavioural or mandate changes on the back of this.

Short sellers will be more cognisant of this new type of herd mentality and will be more thoughtful in the companies they trade. Even if the fundamentals indicate a security is overvalued, they may stay on the side-lines. We may also see few crowded shorts that drive the short interest in a stock to levels that garner attention. This could lead to a greater number of securities having demand, but at lower levels with fewer deep specials and more names in the warm space.

Rennick: Gamestop and other meme stocks did have an impact on hedge fund performance, portfolio construction and behaviour, both short and long term. Initially, short interest among crowded names subsided quickly as hedge funds reduced exposure. Single name demand and special balances decreased for a period of time, as trading against momentum increases risk. After a few weeks, demand rotated to certain sectors, but hedge funds remain cautious. Longer term, more hedge funds will factor in short interest in the decision-making process, as well as social media signals. Potentially uncorrelated, but during the period and throughout most of 2021, ETFs have experienced a significant jump in demand. In fact, demand for ETFs is increasing annually. Perhaps the diversification of using an ETF as a hedge helps offset the short squeeze of a single name, in vogue stock.

Ryan: The securities lending and financing industry is dominated by the laws of supply and demand. Were we to list out the actions, events, and sentiments that can shape these factors in securities lending and finance, this would be a long list. However, the GameStop short squeeze and subsequent debilitating losses by hedge funds have perhaps changed the paradigm. Agent lender rate changes (following the traditional supply and demand playbook) were at times met with strong resistance — with the reasoning being that their clients had "lost enough" on the trade. Albeit indirect, any linkage between a shorts performance and ability to enact a rate change alters the supply and demand calculation.

Aldridge: Overall, the securities lending markets worked as they should and no lenders or agents were directly affected by this activity as far as we are aware. This definitely had a negative impact on demand to borrow securities with high short interest and fees.

Immediately after the events, the US equity specials market was nearly cut in half from a market value perspective and average fees charged dropped dramatically. We think the market for super specials with high short interest remains at risk in the near term. This will have long-term effects for short sellers as they grapple with managing their short investment ideas and the potential risk of falling victim to a short squeeze orchestrated by a crowd of investors. In some cases, we are seeing investors utilise exchange-traded funds (ETFs) to effect their short views, instead of using a single security to reduce short squeeze risk.

What are the key issues for the US securities lending community in promoting high ESG standards across the SLB transaction value chain? How will this impact the range of assets included in the lending programme? And screening of collateral?

Aldridge: One of the key issues is that clients need more timely, valuable data that can help them make the best decisions for their investors, particularly relating to proxy voting. We could potentially see temporary reductions in availability as we get closer to some proxy record dates if more investors begin to recall. We could also potentially see a reduction in availability of some securities as clients eliminate investments in companies that do not meet their ESG standards. Both phenomena have the potential to drive fees higher for those names.

Clients also need the flexibility to modify collateral schedules, without minor changes drastically affecting their returns. Improved technology and automation will be needed in many cases to manage these new standards effectively. Fidelity has deep expertise with ESG investing and we have been focused on it for many years.

Tell: The rest of 2021 will most likely be a continuation of what we have seen in Q3, with low rates overall and a reasonable volume of specials activity in the same theme we have seen so far this year. There may be some volatility as we once again debate our debt ceiling and spending plans, along with messaging from the Fed about the beginnings of tapering off quantitative easing. These could also have some impact into 2022, if over time we begin to lift away from the very low rate environment and have greater opportunities due to widening spreads.

We continue to invest heavily into our technology development and that will be the theme for 2022, not only to enhance our trading capabilities within the existing securities finance platform but also in partnership with other areas of the firm to broaden our collateral, risk management and digital capabilities. Clients are looking for ever more complex and intertwined product offerings. This requires investment of time and resources in multiple businesses to deliver.

Ryan: ESG is becoming more predominant as beneficial owners establish their own policies and stances. We strongly believe that securities lending activities can co-exist happily with the ESG philosophies and approaches of our clients, and that a client's ESG objectives can be factored into a securities lending programme without creating unmanageable conflicts or undue concerns. Each agent lender has built up their ESG "tool-kit" to be overlaid to their clients.

With ESG being so important to MUFG and our programme, we have established a global head of ESG dedicated to securities lending. This person is working with our clients to understand their needs and requirements and with our product development teams to implement policies, procedures and solutions. We are also working in close cooperation with all industry associations to help frame the market discussion.

It remains crucial that we engage upfront with institutional asset holders to explain where conflicts may, occasionally, be identified and how they can be mitigated. Understanding a client's objectives and creating a bespoke programme for clients has always been a cornerstone of our product offering. The current focus on ESG has not changed our philosophy in that respect.

Coker: Recent Industry surveys have shown that ESG principles and securities lending can co-exist, so the range of assets used within the securities lending program is not typically impacted by ESG. The challenge to the lending agent is to ensure it can support clients' needs by ensuring the lending activity is aligned with their corporate objectives. Transparency around short-selling, borrowing practices and recall policies is being supported by the introduction of regulation in some regions (such as SFTR). Proxy voting on behalf of the beneficial owner, with the ability to recall ahead of meetings, is key alongside the ability to restrict and screen collateral based upon clients' ESG needs. This extends to cash collateral reinvestment.

There is a need for refinement around ESG to ensure the continued efficiency of securities lending — for example, adding pressure to secure more timely disclosure of proxy information by companies (to fully support the timing of the recall) and providing clear definition of ESG parameters, which will assist with the creation of standardised ESG collateral sets.

Whilst we focus on the challenges, there are also opportunities within securities lending. For example, the recent issuance of green bonds

has created new revenue opportunities via an improved 'greenium' (the premium on green bond prices). This is currently a watch item as we see how demand evolves.

Nigam: ESG is a major topic for Deutsche Bank and a key focus across the bank, so it is a topic we are quite familiar with. Whereas some clients have historically implemented a form of ESG by limiting investments and collateral holdings of so called 'sin' stocks (for example, tobacco, gambling, alcohol, defence), it has taken until now for ESG to become more mainstream — with the topic now being discussed across our entire client base, particularly in Europe.

That said, the biggest challenge is the lack of a common framework regarding what ESG means and what it should look like. As more indices are created and adopted by investment managers and tri-party providers, ESG requirements and compliance should become more second nature. Until then, we are having to work with clients and counterparties to implement bespoke rules with appropriate compliance monitoring.

Rennick: Securities lending has long supported individual client ESG standards, the most common nexus often identified as governance around proxy voting policies and eligible collateral schedules. In the US, ESG tends to focus on portfolio construction and security selection, away from securities lending. As ESG continues to evolve and elevate in importance and evolve, so too will the securities lending industry. Recently, the Global Framework for ESG and Securities Lending (GFESL) has been developed in partnership by the Pan Asia Securities Lending Association (PASLA), Risk Management Association (RMA), International Securities Lending Association (ISLA) and endorsed by the Canadian Securities Lending Association (CASLA) to meet the need for a globally consistent approach. These are the largest associations representing the securities lending industry and they recognise the broad umbrella of ESG lacks consistency. Therefore, their collaboration sets an ambitious framework for standardisation at the intersection of ESG and securities lending.

How do you assess the outlook for US securities lending markets into 2022 and what is top of your development priorities as a securities lending team?

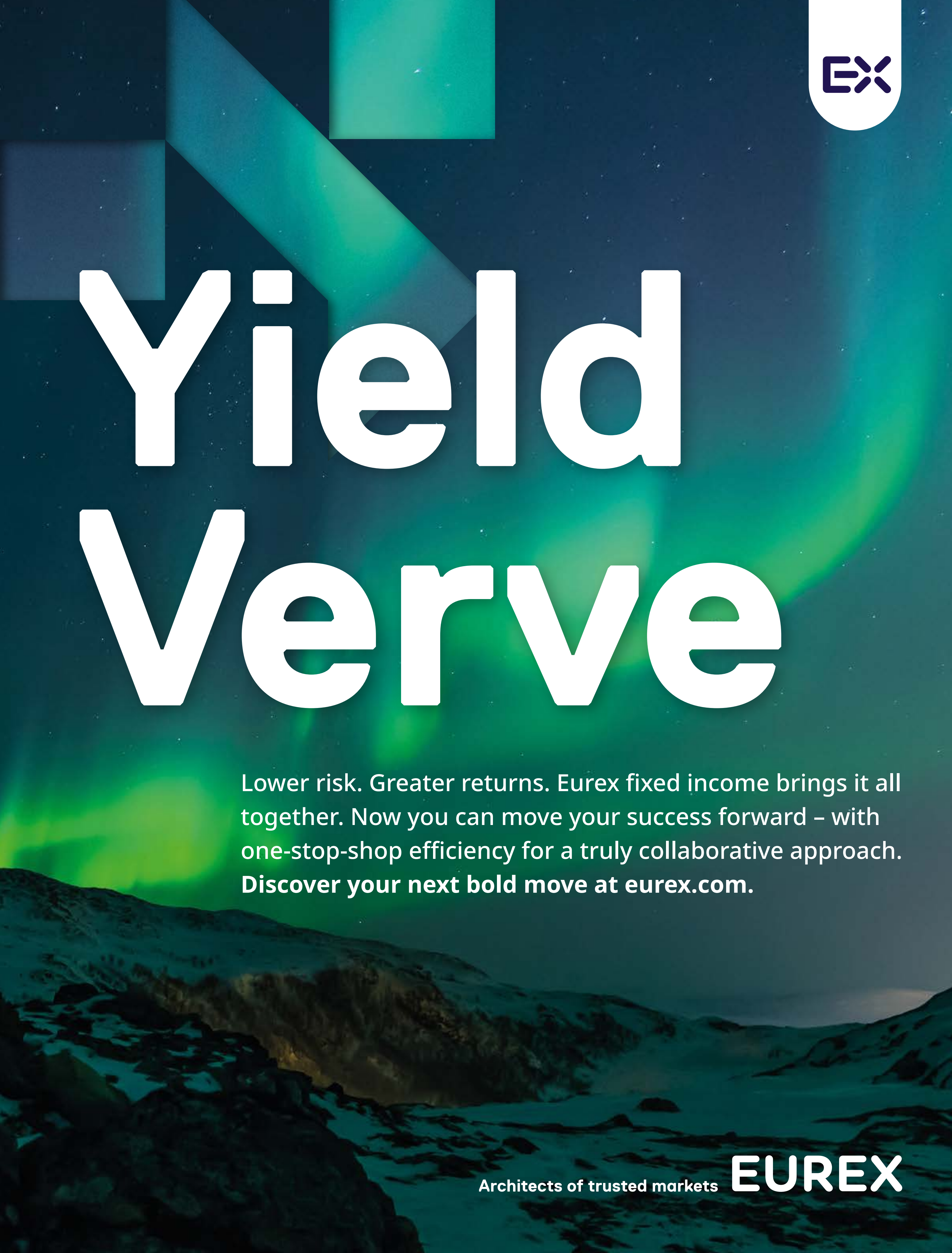
Nigam: For the most part, we see markets treading water as participants look for resolutions or additional guidance on the big macroeconomic items that are currently dominating the agenda – namely the debt ceiling, Fed tapering, the size and extent of the infrastructure bill and, of course, the inflation and interest rate outlook. All of these should see some progress and clarification over the next few months. As differences between expectations and realities take shape, we should see increased volatility leading to additional borrowing and funding activity.

In the meantime, we expect additional inflows into money market funds, especially with the Fed announcing a doubling of their Reverse Repo Program (RRP) counterparty limit to US$160bn per day. Given the extent of excess cash in the system and our primary focus on using government money funds and non-traditional repo as cash investments, Deutsche Bank has been investing heavily in our automated securities lending (ASL) platform. We have also been building our capability to accommodate additional client segments, looking for lightweight and low risk ways of generating incremental returns on their excess balances.

Rennick: Pockets of opportunity exist for the remainder of 2021 and 2022. In the US, Q4 offers macro events including US Federal Reserve tapering, or tapering discussions, US debt ceiling debates, challenges to reopening the economy and potentially two significantly sized stimulus packages ($900mm and $3.5T) that would be funded with significant tax policy changes.

Aldridge: We remain very optimistic about our clients and their securities lending returns going forward. The market and the industry have proven very resilient throughout the COVID crisis, the low interest rate environment and the meme stock frenzy. In 2022, we expect returns to normalise back to 2018-2019 levels, with potentially higher interest rates and increased demand to borrow.

Our top development priorities continue to centre on enhancing our clients' experience through technology and strengthening their connectivity with their custodian and their borrowers, while improving their returns. At Fidelity, we will continue to enhance our automated trading platform, and provide access to our ESG tools and our unique benchmarking and transparency solutions to help clients with their investment decisions. Across the enterprise, Fidelity invests heavily in technology and security and we have more than 20 years of experience in all aspects of securities lending.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Sunil Daswani
Global head of securities lending
Standard Chartered Bank

Seeking a sustainable future

Carmella Haswell reports

Sunil Daswani, Standard Chartered Bank's global head of securities lending, speaks to Carmella Haswell about the importance of ESG, how to reach a sustainable future and what's driving demand and supply within the securities lending market

Standard Chartered is among the 17 opening signatories for revised principles released by the Global Principles for Sustainable Securities Lending (Global PSSL) earlier this month. The principles aim to promote and embed environmental, social and governance (ESG) matters and Sustainable Development Goals (SDG) in securities lending activities.

ESG has been a priority within the market for some time now, with a growing number of investors allocating more than 75 per cent of their portfolio to ESG-compliant assets and 37 per cent making a public commitment to align all or part of their portfolio with a 2050 net-zero target, according to a recent BNP Paribas survey. The dynamic that the securities lending world wishes to attain has never been clearer.

Firms across the securities lending industry have launched platforms and technology that strives to achieve an ESG-friendly solution for its clients. For example, Kaizen Reporting released its ESG monitoring tool, ESI Monitor, in September. The tool provides a framework for its clients to measure and manage environmental and social impact, revealing a client demand to reach a greener way of life.

The importance of ESG

Speaking to SFT, Standard Chartered Bank's global head of securities lending, Sunil Daswani, explores the importance of becoming an open signatory for the revised Global PSSL principles.

He says: "ESG has been on the agenda for many years, but there is a recent acceleration across all industries to embed ESG priorities into their business models. We are committed to delivering sustainable banking and the Global Principles for Sustainable Securities Lending will help to support the work we are doing to incorporate ESG into our services, as we align with the priorities of our clients and the communities we operate in."

Despite a number of indices being available to support investment decision-making around ESG, Daswani believes there is a long way to go in establishing a consistent way of measuring and comparing fund performance at an industry level.

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

"However, we are seeing various initiatives emerge to develop ESG measurement and comparison tools, both amongst individual providers and at a wider industry level. One of the most promising of these is the Global PSSL initiative. This aims to create a global ESG market standard for owners, lenders, borrowers and impact creators, such as Standard Chartered."

Reaching sustainability goals

In May 2021, Standard Chartered announced the execution of its first ESG-linked derivative with Trafigura. The transaction involved combining conventional derivatives risk management with sustainability-linked key performance indicators (KPIs) that are linked to reducing greenhouse emissions from owned or controlled sources, and to sustainable sourcing in the base metals business.

The firm also provides a collateral filtering and monitoring service that gives asset managers the assurance that their investors' ESG priorities are reflected through the securities lending process.

Daswani says: "Given that an investor cannot participate in shareholder votes (typically via proxy), when they have lent a security, they may decide to recall a security to allow them to do so. This issue resonates specifically for ESG-driven investment, where institutional shareholders may play an important role in defining a company's ESG strategy.

"Our configurable, automated share recall service enables clients to make informed decisions on whether to recall securities or leave them on loan. This service helps reduce the opportunity cost by limiting the frequency of recall, and the time period for which securities are removed from the lending programme, whilst enabling investors to engage on key strategic issues."

Demand and supply

The driving factor of demand and supply within the securities lending market is forever changing, especially when impacted by uncertain times, which has been brought by the COVID-19 pandemic. Daswani reveals that a "negative impact" on revenues has resulted from the combination of volatility and economic uncertainty, as loan demands have reduced, with hedge funds deleveraging and short-selling bans in some markets.

He says: "Lenders have generally taken a calm approach to managing risks arising from COVID-19 and adjusted their securities lending programmes accordingly. One big change since the global financial crisis is the increased transparency in securities lending programmes, so beneficial owners have a better understanding of their programme and the risk parameters.

"As we go through 2021, emerging markets continue to be an attractive sector, with relatively low levels of lendable supply and additional operational requirements leading to higher returns for lenders, particularly early market entrants. As we have seen in countries such as South Korea, Taiwan, Malaysia, and more recently, Russia, initial demand often outstrips supply as new markets open up, and we are likely to see the same in the coming year in China, and other newly emerging markets for securities lending."

A growing market

After just over 12 months as Standard Chartered's global head for securities lending, Daswani reveals the changes he has seen within the sector during this time and what is driving the company's development focus.

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

He continues: "Data is key to this, as we have seen with the implementation of Securities Financing Transactions Regulation (SFTR) reporting that took effect in 2020. In addition, the Central Securities Depositories Regulation (CSDR), which aims to harmonise timing and standards of conduct in the European securities settlement industry, will also have an impact, but with the implementation delayed to February 2022, the effects are not yet clear."

Digitisation is also a priority for securities lending markets, which has become key to regulatory and market endeavours to drive standardisation and efficiency, according to Daswani.

He explains: "Securities lending is already advanced in the use of technology, with more than 90 per cent of securities lending trading volume now done through automated lending platforms, a shift that few would have anticipated 20 years ago".

The common Domain model also appears to be gaining good traction within the industry. "This is something which Standard Chartered remains committed to supporting as ISLA drives this item on the agenda forward," says Daswani.

HQLA X

Making lending sustainable

Xavier Bouthors, senior portfolio manager, investment solutions, NN Investment Partners, talks to Bob Currie about responsible investment, sustainable lending and the direction of NN IP's securities finance strategy

In its mission statement, NN Investment Partners (NN IP), the Netherlands-based fund manager, highlights the importance of managing assets responsibly — “because it is important and it works”. As a responsible investor, NN IP aims to improve client returns and the world we live in. “We do this by looking beyond finance performance, because the people we work for, and with, represent more than the investments we manage,” it says.

In line with this objective, Xavier Bouthors notes that a commitment to sustainable development has been central to the evolution of NN IP’s securities lending strategy. In recent years, the asset manager has been working closely with stakeholders across the loan transaction value chain, alongside industry associations and responsible investment groups, to promote sustainability parameters in lending activities.

This involves considerations ranging from voting strategies and procedures for stock recall, to collateral screening and exclusion, alongside steps to monitor the responsible investment standards of its lending counterparties, for example alignment of codes of conduct and tax principles.

NN IP has developed its securities lending programme to comply with the Dutch Stewardship Code, along with the second EU Shareholder Rights Directive (SRDII) and the Principles for Responsible Investment. Its day-to-day practice is also influenced by the Bank of England’s UK Money Markets Code of Conduct which guides best practice in unsecured, repo and securities lending markets.

The investment group is an active participant in the International Securities Lending Association (ISLA) ESG working group. It was also one of 17 opening signatories to the Global Principles for Sustainable Securities Lending, a community of organisations working to develop a global market standard for sustainable lending according to a principles-based approach.

NN IP currently has close to €300 billion in assets under management, of which 74 per cent are ESG integrated, according to the firm.

On 19 August, NN Group issued a joint statement with Goldman Sachs indicating that the Hague-based investment manager will be acquired by New York-based Goldman Sachs group for close to €1.6 billion. The deal is expected to close by the end of Q1 2022. It was too early at the time of interview to reflect on how this acquisition will affect the firm’s approach to securities lending.

How do you assess the performance of NN IP’s securities lending programme over the past 12 months?

For the year-to-date, we have experienced year-on-year growth in securities lending revenues, accompanied by new trading opportunities and greater openings for collateral upgrade transactions. Banks are looking to access high-quality government securities on an evergreen basis, delivering lower quality assets as collateral. We are constantly assessing with our clients the trade-off between risk and reward, for example accepting a wider range of collateral or applying different haircuts in return for better returns.

At NN IP, we support a number of different types of client. This includes multiple UCITS portfolios, but also pension and insurance portfolios within the group. We have also had new third-party clients joining our securities lending programme. There have been attractive opportunities to generate value for institutional investors from term trades as they align well with the relatively stable buy-to-maintain liability-driven investment (LDI) portfolios. These are a valuable, stable source of high-quality liquid assets (HQLA) for collateral transformation term trades.

Fee rates have varied substantially depending on the asset class and the borrower. But, in broad terms, we have seen revenue growth across a broad range of equities, as well as high-yield debt and emerging market government debt.

This said, we do not endorse headlines in some parts of the news media that 2021 has been a bonanza year for securities lending. We do not see the market in those terms currently, particularly because some of the highest revenue earners have been concentrated in specific equity and corporate bonds specials that we do not always hold.

So what has been driving growth through your lending programme?

Particularly through deepening our lending activities with counterparties where NN IP has wider trading relationships. We have been able to leverage these trading links to extend loan volumes and ensure attractive returns and utilisation. Some counterparties choose to interact directly with NN IP on more structured trades — perhaps not wanting to reveal insights to an agent lender about their trading strategy or how they position themselves from a pricing standpoint — and are attracted by opportunities to access loan supply through NN IP's lending programme building on existing links between the two organisations. The collaboration with our agent lender, Goldman Sachs Agency Lending, was key to support this.

At the same time, NN IP has applied tight scrutiny to our list of eligible counterparties, evaluating these firms not just for credit risk, but also to ensure they comply with the sustainable investing criteria that we apply across our investment and lending programmes.

For UCITS portfolios, there are restrictions on how we lend and what we can accept as collateral. UCITs are tightly regulated in terms of the risk they can take on through lending activities. ESMA rules dictate that assets held in UCITS fund portfolios cannot be used in term trades (ie loan transactions should be for no more than 7 days) and collateral accepted in lending transactions must meet specific credit-quality requirements and concentration limits.

From a geographical perspective, we have made incremental rather than far-reaching changes to our lending coverage. NN IP has been active in equities lending in most developed and emerging markets where we have securities in inventory and where lending is permitted.

This is also the case for emerging markets debt (EMD), particularly for foreign-currency government bonds. We identify selective opportunities to expand our lending for local-currency government bonds in some emerging markets. However, this will be the result of detailed due diligence and evaluation of local regulation and market practice, which can be complex for local currency EMD lending in some jurisdictions.

In recent market conditions, we have noted some lenders have been willing to look further down the credit-quality spectrum in terms of collateral they will accept in repo or securities lending transactions. Given the near-zero (or sub-zero) interest rate environment and the abundant liquidity that has been available since the start of the year — the product of massive central bank liquidity interventions since the onset of the Covid-19 crisis — it remains problematic for firms that are long cash to generate an attractive yield on their cash holdings. Some firms have been willing to widen their collateral tolerance in search of additional yield.

At NN IP, we have taken a cautious approach to widening our collateral eligibility, recognising that in the event of counterparty default we must be able to liquidate collateral within our required timeframe — and that this may be difficult for illiquid or lower credit-quality assets in conditions of market stress.

What are the key lessons learnt over the past 18 months?

The first lesson is that liquidity can dry up very quickly. All firms that rely on secured financing transactions to meet their funding requirements must have a strategy in place to protect their access to liquidity as conditions tighten. The repo market spike in the US triggered significant liquidity tightening during Q4 19 – and then the Covid-19 pandemic sparked severe tightening in the EU commercial paper market, creating pressures on short-term funding, from March 2020.

This experience has reinforced how important strong trading and funding relationships have been in helping us to negotiate these challenges. Internally, this also reinforces the importance of the rigorous scenario analysis and stress testing that we conduct to model our resilience under different types of market distress.

We have read a lot about potential collateral scarcity, but we see little evidence of this developing in current market conditions. Central bank asset purchasing programmes have sucked in large volumes of high-quality assets, causing central bank balance sheets to expand to unprecedented levels. However, high levels of government debt issuance, used to finance government interventions during the Covid-19 crisis, have largely offset any potential shortage of high-quality liquid collateral.

There were advanced warnings of liquidity tightening as we moved towards the 2020 year-end — triggered by banks looking to reduce their balance sheets in preparation for their year-end reporting — but in practice the year-end was negotiated with little disruption to the market.

As we moved into 2021, the Archegos insolvency has reminded us that defaults do still happen and these can result in large losses for investors and banking counterparties. This point was made forcefully 13 years ago with the collapse of Lehman Brothers, but the passing of time should not lead us to underestimate current risks or to relax our threat detection framework. Several banks suffered major losses

as a result of Archegos, but they are still in business. Had one of these defaulted, we need to be clear how this would have affected our business and be sure these risks were properly mitigated.

In light of G20 reforms, and internal lessons learnt from the financial crisis, do you feel safer than you did in 2008?

Only in certain respects. Archegos exposed some of the dangers embedded in bilateral relationships between a hedge fund and its bank counterparties. Reforms introduced after the 2008 financial crisis — for example, to encourage central counterparty clearing of securities and derivatives transactions, to require reporting of OTC derivatives transactions to a registered trade repository — did not prevent the Archegos default or provide significant early warning to financial regulators. Archegos' swap positions, for the most part, were not centrally cleared and margin requirements were managed bilaterally between the fund manager and the bank's prime services division.

What role do agent lenders, tri-party collateral managers and other external specialists play in supporting your programme? And how is this changing?

This is a highly competitive market, with agents knocking on the door to win new business from buy-side lenders. However, we have used the same agent lender since 2008, when NN IP first entered the securities lending market, and we have had strong continuity with this service provider.

In fulfilling our stewardship responsibilities, it is imperative that we have strong oversight of outsourced service relationships and provisions in place for benchmarking service quality. Our agent lender has met our service requirements consistently during recent periods of market uncertainty and this has been borne out by strong service performance benchmark scores. With implementation of the Securities Financing Transactions Regulation (SFTR) in 2020, our service provider also played a key role in delivering an outsourced reporting service that ensures our compliance with this regulation.

We have taken the decision to extend our tri-party collateral management options over the past two years and now employ two tri-party collateral specialists rather than one. Typically, the choice is driven by the needs of our counterparties. When trading with a counterparty's fixed income desk, typically this will dictate that we use Euroclear as tri-party; when dealing with a firm's equity desk, this will direct activity towards BNY Mellon as tri-party agent.

As a collateral receiver, we are well equipped to support efficient collateral movement through these third-party relationships. The challenge is to put our collateral inventory to optimal use, identifying whether we can be most efficient through posting a piece of collateral as initial margin, in meeting requests for variation margin, deploying this in securities lending or repo transactions, or through other uses.

Looking ahead, what are the immediate priorities for your securities lending and financing strategy?

Regulatory changes will be a primary driver. We continue to review our responsibilities as a sustainable investor, including how our obligations under the Sustainable Finance Disclosures Regulation (SFDR) will impact our approach to securities lending. We have drawn on internal opinion from NN IP's in-house regulatory experts, as well as key information sharing via the International Securities Lending Association's (ISLA's) ESG working group and Beneficial Owner group.

NN IP's approach as a buy-side lender is that under SFDR Article 6 and Article 8 ('light green funds') fund assets may be used for lending, providing that we have approval from the relevant portfolio management teams.

In addition, we are currently preparing for implementation of the settlement discipline regime component of the Central Securities Depository Regulation (CSDR), which is scheduled to become active in February. We are monitoring the potential drag this imposes on our lending activity, when the potential costs of fulfilling reporting requirements are taken into account, alongside any potential costs of settlement fines and mandatory buy-ins. Although some markets have operated settlement fines and voluntary buy-in provisions for a number of years, this will take on a different weight when mandatory buy-ins are enforced through regulation.

Notwithstanding the volatile market conditions that we have encountered over the past 18 months, more institutional investors are now exploring the potential benefits that securities lending can deliver in this low-return environment. This has resulted in new potential beneficial owners entering the market and more lenders entering into dialogue around shareholder engagement and sustainable investment principles. This can only be healthy for the industry.

Ted Allen
Director of business development, securities finance and collateral
FIS

Global inventory consolidation

Ted Allen, director of business development, securities finance and collateral at FIS, talks with SFT about the use of global inventory consolidation and collateral optimisation as a means of improving asset utilisation across treasury, securities finance and cross-product collateral management

What makes inventory consolidation and optimisation such a hot topic in today's securities finance and collateral marketplace?

In general, financial firms lack visibility into asset portfolios that span across securities lending and borrowing, repo, outright buys and sells and cross-product collateral management. Many firms are unable to view their global set of inventory positions in one centralised tool, much less allocate them in an optimal way.

Position, trading and collateral data is held across multiple silos of systems, geographies and legal entities. Those silos might also be split by asset class and they will be trading physical and synthetic assets. Each of these silos may well have their own view of their inventory and collateral and have goals on how it should best be allocated.

The problem comes when there is no single point to bring all of this together and there is no central, consolidated inventory view on which to base overall collateral optimisation decisions or gauge success. Of course, each entity or desk is motivated to maximise their own return on assets, but what is best for one desk is not always best for the firm as a whole.

Tracking and optimising the sources and uses of collateral can have a real impact on balance sheet and profitability. The sooner you can stop the problem, the sooner you can start seeing an improvement.

Is this a sell-side specific problem or is this relevant for the buy-side too?

This is an issue that impacts both the sell-side and buy-side. Banks often face the issue of silos. For an asset manager, the problem looks somewhat similar, but you're also working across a multi-fund structure. Clearing firms face similar problems with allocating client and house collateral across a broad set of exchanges.

The first part of the problem then lies in how you bring the inventory data together in real time. There are several things that make that hard to achieve:

- siloed systems don't always talk to each other.
- if they do try to speak to each other, they don't speak the same language because the industry, in general, still has data standardisation problems.
- they might not have up-to-date views of the inventory data themselves. For that, you need to know not only what your theoretical traded position is in real time, but also what has settled, what is pending and what might be failing.

Is there a cost to do nothing?

The short answer is yes, and it can be quite expensive. With so many assets being pulled in so many directions – including treasury or liquidity needs, derivatives collateral requirements, securities lending, regulatory capital requirements – it is difficult to determine what in the portfolio has been put to best use. Not having a real-time view of inventory naturally leads to missing out on revenue-generating opportunities and higher collateral costs. You'll need to hold larger buffers to cover your intra-day settlement and liquidity risk.

How can global inventory consolidation and collateral optimisation be achieved?

There are three building blocks for a globalised view of inventory. They are:

- normalisation of data: this makes it possible to share information across systems with nothing lost in translation. Particularly important are securities, requirements and collateral schedules.
- real-time connectivity with trading and position management systems: this should be enterprise-wide, across business and regional silos.
- real-time connectivity with custodians: up-to-date

settlement data lets firms know exactly what is in the box at any given time.

If those three fundamentals are in place, then asset allocation optimisation can start. Optimisation, of course, can mean different things depending not only on who you are talking to but also when you are talking to them.

The optimisation goals of a firm can change from minimising the opportunity cost of the positions (if I post this treasury as collateral, I forego the revenue I could have made from it), to minimising the cost of the balance sheet (if I upgrade this position through the securities lending market, my opportunity cost may reduce but at the same time my RWA goes up). The optimisation goals of an international broker-dealer may not be the same as the goals of a pension fund manager. All this means you need to have flexibility to easily configure different optimisation scenarios and the ability to run different scenarios and stress tests.

Sounds like an ambitious project. Are there any shortcuts?

FIS has launched a comprehensive, centralised tool that normalises and aggregates position data across the firm, in real time, providing the tools needed for collateral optimisation and to make the best overall use of inventory. We imaginatively call it the FIS Global Inventory and Optimization Platform.

It's a cloud-native solution, so it is very lightweight. It effectively sits on top of existing infrastructure, making it easy to connect disparate silos without having to do a wholescale replacement of your existing systems and processes. We've made it simple and cost effective to deploy and simple to configure.

How does the platform work?

It runs alongside existing treasury, securities finance and collateral systems, providing a measurable basis point to impact a variety of allocation outcomes. You can set optimisation rules based on internal requirements, define fixed and variable costs, prescribe asset sources and specific uses, then create models to achieve your desired results.

For instance, eligibility schedules, concentration limits, settlement timing, counterparty preferences within your own risk tolerance and optimisation goals can be modelled and tested using the platform's decision-analysis capability. The resulting suggestions cover how to allocate assets to your funding requirements, your derivatives collateral requirements, your securities lending programme and more, including where it makes sense to upgrade or transform collateral. It will automate substitutions and collateral transfer pricing and, if you are happy with the suggestions, a simple click will book the trades in the downstream systems.

The solution also includes FIS Securities Finance Market Data (formerly Astec Analytics), so you get access to intra-day market data to drive the optimisation and further develop mission-based stress tests and allocation scenarios.

What can a firm expect to gain from the FIS Global Inventory and Optimization Platform?

The platform provides the means for a liquidity and collateral manager to maximise returns from securities lending, minimise the cost of collateral and minimise the balance sheet impact of securities allocations across business lines. It features the latest technologies – a smart analytics engine and RPA-driven workflows that automate inventory allocations while supporting continuous improvement over time.

It's quick to deploy, cost-effective to run and easy to integrate. Clients adopting it will get fast, accurate views of global inventory in real time with powerful calculations for optimal allocation of assets.

That all sounds great, but can you summarise the key message we should take away from this?

Operating in silos means you cannot mobilise the full inventory, so costs of funding and collateral will be higher and you may not be maximising the revenue from your lending.

There is a solution. FIS has a new, cloud-based offering that you can quickly and cost-effectively use to mobilise your assets. The Global Inventory and Optimization Platform can be layered over the top of underlying systems, so they remain intact.

How do I learn more?

Anyone that would like to learn more is welcome to contact me directly at **Ted.Allen@fisglobal.com**

Transcend, J.P. Morgan and Itiviti Group latest hires and more

Morris exits Bloomberg Regulatory Reporting Services.

Morris joined the role in March 2018, fronting sales on the Bloomberg regulatory reporting hub, a global multi-asset regulatory reporting solution that provides consolidated reporting for a wide range of regulatory obligations including the European Market Infrastructure Regulation, the Markets in Financial Instruments Regulation and the Securities Financing Transactions Regulation.

For 18 months prior to this, Morris was head of sales for Europe at RegTek Solutions, which was acquired by Bloomberg in August 2019.

He also worked in the regulatory reporting solutions team at NEX Regulatory Reporting from October 2016 until March 2018.

Earlier in his career, Morris held senior sales and relationship management positions at MarketAxess, NASDAQ OMX, London Stock Exchange and Markit.

Kaizen Reporting welcomes several new appointments including former J.P. Morgan vice president, Faizal Shaikh.

Based in London, Shaikh becomes the SFTR money markets regulatory reporting specialist for the company.

With over 15 years of experience specialising in regulatory operations and projects, financial

South Street Securities appoints Andrew Leone

South Street Securities hires Andrew Leone as managing director of equities finance.

Based at the firm's New York headquarters, Leone will be imperative in cultivating the equity finance and Delta 1 trading business.

Prior to his new role, Leone spent six years with Nomura Securities, where he managed trading for securities lending and various strategies in equity products. In 2004, Leone joined Satellite Asset Management, a multi-strategy hedge fund, as head of securities lending and equity derivatives.

Here, he co-managed and traded a special-purpose acquisition company (SPAC) portfolio and worked on Special Situations. He was also responsible for funding Satellite Asset Management's credit positions through various structures until the fund was unwound in 2008.

In 2010 he joined MUFG where he successfully built out the securities lending and equity derivatives platform. Over his 10 year tenure, he was responsible for managing the securities financing team and their activities until departing in 2021.

planning budgeting and costing, as well as controller and people management, Shaikh was vice president for J.P. Morgan for 17 years prior to this role.

He has worked extensively with Markets in Financial Instruments Directive (MIFID II), European Debt Management Office, PRA Liquidity, European Markets Infrastructure Regulation (EMIR) and most recently, Securities Financing Transactions Regulations (SFTR) reporting.

Shaikh was also a senior accountant in India for Compass Connections for three years, prior to his work with J.P. Morgan.

Additional hires joining Kaizen Reporting this month are Michelle Rowe, Sydney Mott, John McElroy, Alberto Capozza, Anas Khan, Wanying Zhou and Anthony Nutting.

Itiviti Group has appointed Dumas Maugile as senior sales executive.

Itiviti was recently acquired by Broadridge, with the deal completed in May.

Based in London, Maugile has more than 20 years' experience in financial services.

Prior to joining Itiviti Group, Maugile served at Societe Generale specialising in delta one and equity finance, covering European hedge funds from 2014 to 2021.

Before that he was managing partner at PrimeTrading Management from 2009 to 2014.

He has also served at Morgan Stanley as an executive director from 1998 to 2009.

Jason Arboreen joins Transcend

Transcend announces the appointment of Jason Arboreen, former J.P. Morgan executive director, as business specialist.

Based out of the New York office, Arboreen will help firms optimise collateral usage across business lines to maximise value and overcome the complex challenges of today's financial infrastructure.

With over 20 years of financial industry expertise, Arboreen most recently served as executive director for J.P. Morgan for nine years, where he held many roles within the equity finance and securities services lines of businesses.

Prior to this, he held positions at UBS and Goldman Sachs where he implemented several arranged financing, portfolio accounting and performance measurement products.

"Jason brings a strong combination of prime services and securities finance expertise to Transcend," says Bimal Kadikar, CEO at Transcend. "As we round out our team of practised financial services professionals, we are thrilled to have Jason onboard and leading product innovation for prime and securities finance businesses."

Arboreen adds: "An inefficient use of collateral is simply no longer acceptable given the significant pressure that financial firms are under to reduce balance sheet usage. I look forward to accelerating the optimisation of collateral usage and driving tangible value for Transcend's clients."

J.P. Morgan hires Ryoji Kanazawa

J.P. Morgan appoints Ryoji Kanazawa to its platform sales, collateral services team in Japan.

Kanazawa will help the expansion of Japan's sales footprint and will be focusing on local Japanese opportunities, reporting to Will Jeffries.

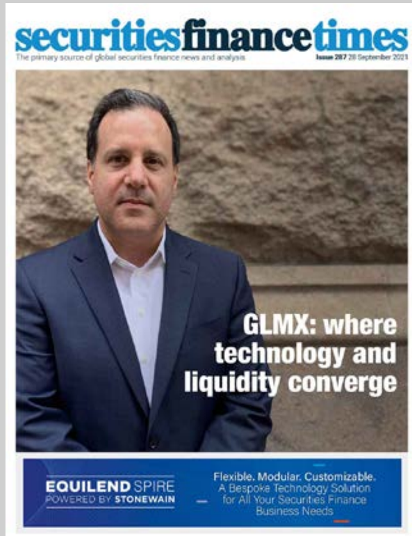
He has 15 years of experience in service, sales and relationship management across securities finance and collateral management.

Prior to this role, Kanazawa spent almost three years as service director, lead manager at BNY Mellon in Tokyo, handling securities lending, global custody, foreign exchange, alternative investments and offshore funds.

Before this, he was a director at Morgan Stanley MUFG Securities for eight years, responsible for securities financing and collateral operations in the institutional securities group. He also worked for one year as an account manager for global securities financing at State Street. Both roles were based in Tokyo.

FinOptSys, a securities finance platform that launched in May, has appointed Elizabeth Rotem as director of business development.

Based in New York, Rotem will lead new product development as well as global sales, strategy and the expansion efforts of FinOptsys. She will help drive new customer relationships while strengthening existing ones around the world.



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Upcoming Securities Finance Training

Non-Cash Collateral Fundamentals

Date: 12 October 2021
Location: Online
Provider: Consolo

This live on-demand training course is designed for new entrants to the industry who require an overview of the securities lending transaction and process involved in execution.

SFTR Analysis

Date: 15 October 2021
Location: Online
Provider: Consolo

SFTR is undoubtedly the most significant regulatory change to impact securities lending for over a decade. As the reporting requirement deadline begins to loom, this one day course provides an opportunity to hear how the market is preparing itself and what challenges remain unanswered.


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