

Securities Finance Americas Guide 2022

Summer 2022

www.globalinvestorgroup.com

T+1 SETTLEMENT

GOOD IDEA, SHAME ABOUT THE TIMING?

PEER-TO-PEER

CONTINUES TO EVOLVE

**MAKING THE MOST OF
REGULATORY TECHNOLOGY**



**COUNTRY
PROFILES**

Key developments in the
major Americas markets



Flexibility.
Reliability.
Durability.



 BNY MELLON

There's No Substitute for Certainty.

certainty-bnymellon.com

EDITORIAL**Managing editor**

Paul Golden
paul.golden@euromoneyplc.com

Derivatives editor

Radi Khasawneh
Tel: +44 (0) 20 7779 7210
radi.khasawneh@euromoneyplc.com

Senior reporter, Securities Finance

Ramla Soni
Tel +44 (0) 20 7779 7246
ramla.soni@euromoneyplc.com

Design and production

Antony Parselle
aparselledesign@me.com

BUSINESS DEVELOPMENT**Business development executive**

Jamie McKay
Tel: +44 (0) 207 779 8248
jamie.mckay@globalinvestorgroup.com

Sales manager

Federico Mancini
federico.mancini@euromoneyplc.com

Head of sales, News & Insight

Sunil Sharma
Tel: +44 (0)20 7779 8556
sunil.sharma@totalderivatives.com

Divisional director Jeff Davis**Chairman** Leslie Van de Walle**Chief executive** Andrew Rashbass

Directors Jan Babiak, Colin Day,
Imogen Joss, Wendy Pallot,
Tim Pennington, Lorna Tibbian
© Euromoney Institutional
Investor PLC London 2022

SUBSCRIPTIONS

UK hotline (UK/ROW)
Tel: +44 (0)20 7779 8999
US hotline (Americas)
Tel: +1 212 224 3570
hotline@globalinvestorgroup.com

RENEWALS

Tel: +44 (0)20 7779 8938
renewals@globalinvestorgroup.com

CUSTOMER SERVICES

Tel: +44 (0)20 7779 8610
customerservices@globalinvestorgroup.com

GLOBAL INVESTOR

8 Bouverie Street,
London, EC4Y 8AX, UK
globalinvestorgroup.com

Global Investor (USPS No 001-182) is a full service business website and e-news facility with supplementary printed magazines, published by Euromoney Institutional Investor PLC.

ISSN 0951-3604

Published in August 2022

Contents

- 4 Peer-to-peer lending** - As the peer-to-peer market continues to mature, we assess some of the key developments and look at how the various market participants are adapting
-
- 9 BNY Mellon** - Making the most of peer-to-peer lending
-
- 11 Industry diversity, equity and inclusion** - Representatives of the London, Toronto and Boston chapters of the Women in Securities Finance (WISF) group offer an update on developments over the last 12 months
-
- 16 BNP Paribas** - Securities lending opportunities in a rising rate environment
-
- 20 Regulatory technology** - exploring opportunities for regulatory technology growth in the securities lending space
-
- 24 RBC** - Decoding new guidance on ESG investing
-
- 27 Wematch** - User collaboration goes down well stateside
-
- 30 Settlement** - Market participants are generally in accord over the merits of moving to T+1 in the US, but concerns remain about the timeframe for achieving this switch
-
- 36 OCC** - The evolution of the stock loan industry
-
- 39 Risk management** - The director of global markets risk and securities lending at the Risk Management Association (RMA) assesses progress on tokenisation of assets and the integration of ESG considerations into securities lending in the US
-
- 41 Country profiles** - A round-up of the major developments in securities finance in Argentina, Brazil, Canada, Colombia, Mexico and the United States over the last 12 months



4



11



21



34



39

Peering over the horizon

As the peer-to-peer market continues to mature, we assess some of the key developments and look at how the various market participants are adapting.

Last year we reported that proponents of peer-to-peer securities lending were confident that its wider use would facilitate deals that would not have happened in a conventional transaction environment.

The term peer-to-peer can be used to describe bi-lateral trading between asset owners, but it doesn't end there according to Christopher Benish, asset & risk allocation portfolio manager at State of Wisconsin Investment Board.

"I am having more conversations about how securities finance is a broad category of activities that includes securities lending as one tool among many including swaps, repo, and collateral transformation," he says. "These tools can be employed between agents, banks and brokers, but also between non-traditional counterparties such as pension

funds, insurance companies, and other asset managers."

Benish observes that the Global Peer Financing Association (GPFA) has grown from four funds when it launched in the summer of 2020 to 24 global asset owners representing over \$10 trillion in assets.

Discussion points

"In April 2022, we held our first in-person meeting as an association, bringing together nearly two dozen beneficial owners to discuss a wide range of issues over the course of two days," he says. "We came away with a lot of ideas for future topics for discussion."

The GPFA board has not emphasised the trading aspects of peer-to-peer as much as the interaction and best practices of the participant members explains Mike Pramik, a

spokesperson for the Ohio Public Employees Retirement System.

The conversations happening within the GPFA may eventually lead to bilateral transactions, but Benish agrees that that is not the focus of the association.

“We focus on understanding different transaction types so our members feel comfortable finding what works for them,” he says. “It might be as simple as expanding the list of approved counterparties at their agent lender. It might mean getting involved with centrally cleared repo or it might lead to setting up a bilateral lending, repo or swap agreement with another asset manager and trading directly. More routes to market and a more diversified group of counterparties means more business overall, which benefits everyone and makes markets more efficient.”

Many agent lenders have been supportive and engaged from the outset and very few asset managers are in a position to completely divorce themselves from an agent, adds Benish.

“Whether it is counterparty indemnification, operational infrastructure or trading capacity, most beneficial owners benefit from agent or broker relationships,” he says. “Many agents have non-traditional counterparties as part of their very traditional lending programmes. They might not call it peer-to-peer, but it is happening and the more this activity is normalised and understood, the easier it will be to connect lenders and borrowers of securities, collateral, liquidity, etc.”

Owner acceptance

Pramik refers to the growth of the GPFA as evidence of acceptance by owners and says it continues to receive questions and interaction from potential members.

“As owners come to realise that this organisation is not focused on trading facilitation, but is about addressing beneficial



“ More routes to market and a more diversified group of counterparties means more business overall, which benefits everyone and makes markets more efficient. ”

– Christopher Benish, State of Wisconsin Investment Board



owner and asset manager needs, acceptance and participation of membership has increased,” he says.

On the question of whether it has helped to generate a higher volume of transactions rather than simply redirect existing business, Pramik observes that those organisations who have engaged in peer-to-peer transactions seem to be doing so to supplement existing business.

“Diversifying counterparts and sources of financing through alternative means seems to be a legitimate reason for many to engage in these types of transactions,” he says.

According to Peter Bassler, managing director business development at



“Capital costs and risk-weighted asset concerns are driving innovation that has also helped push peer driven initiatives to the forefront.”

Peter Bassler, eSecLending

eSecLending, the focus on the peer-to-peer lending segment of the market has increased significantly over the last 12 months as many securities finance firms focus on alternative counterparties.

“Additionally, the growth of the GPFA has continued to bring focus to peer-related activity,” he says. “Capital costs and risk-weighted asset concerns at both the large custodians and borrowing counterparties are driving innovation that has also helped push peer driven initiatives to the forefront.”

Additional trades

Bassler observes that the vast majority of peer-to-peer trades eSecLending’s clients are doing are additive to client programmes rather than

redirecting existing business from traditional counterparts.

“The peer-to-peer business to date is largely driven by low spread trades that traditional counterparties no longer want to participate in due to regulatory hindrances and the impact that has on supply and demand factors within each counterpart business,” he adds.

“Peer counterparties - although mostly unrated by traditional NSRSO agencies because they typically do not have a need to seek a credit rating - have strong credit profiles and can provide stable balances where traditional firms have sensitivities around quarter-end and year-end reporting periods.”

In eSecLending’s experience, acceptance across beneficial owners has broadened over the last 12 months, especially with pension funds, sovereign wealth funds and other entities that don’t have a regulatory structure that prohibits transacting with non-traditional counterparties.

For example, mutual funds regulated by the 1940 Act lenders have highly restrictive parameters that currently prohibit the ability to engage in most peer-to-peer activity.

Bassler agrees that agent lenders have become more relaxed about peer-to-peer lending. “We are driven by our client priorities and never saw peer-to-peer as a threat to our core business,” he says. “If our clients can make more money, we make more money and as noted earlier, many of our clients engaged in peer transactions have added incremental revenue to their programme over the past seven-plus years.”

He suggests that peer trading is not that different or much more complex than lending or repo transactions with traditional counterparts. “We simply adjust our business model to support peers with all the same operational, legal, and indemnification leverage points to help get innovative transactions done. Some more traditional firms have also

shifted focus to peer-to-peer, viewing it as an alternative which is increasingly becoming a necessity as they seek to find ways to relieve risk-weighted asset and capital concerns for their organisations.”

Mark Faulkner, co-founder Credit Benchmark agrees that overall market development and growth is encouraging.

Repo growth

“Agent banks have launched their own directed/peer-to-peer repo platforms and sponsored repo has grown in popularity,” he says. “Other third party providers continue to enter the space to provide operational support and data for participants within the peer-to-peer ecosystem(s) and there is widespread recognition of the need for ongoing life cycle support of peer-to-peer-initiated transactions.”

As for whether asset owners have embraced the concept, Faulkner notes that asset owners are typically conservative and smart and that beneficial owners are increasingly aware of regulatory and capital changes suffered by their agent and principal banking partners.

“This awareness is having an impact upon the economics of doing traditional financing business,” he adds. “This change in the market is encouraging some organisations to consider dealing with non-traditional and alternative peer-to-peer counterparts.”

Across the industry over the last year, J.P Morgan has observed increased investment in infrastructure from the banks to support agented securities financing transactions, including peer-to-peer activity which allows banks to continue to earn revenues from operational servicing elements of transactions while significantly reducing balance sheet usage.

“Other parts of the financing landscape which play a role in assisting such activity have also evolved, including price discovery and execution platforms, the provision of separate



“ While the market platforms are adapting for scale, we have not seen a widespread increase in generic peer-to-peer transactions outside of some nuanced, bespoke arrangements. ”

William Smith, J.P. Morgan

.....
financing credit wrappers or guarantees, and the increased use of cleared venues,” says William Smith, platform sales J.P. Morgan.

Collateral sourcing

The roll down of the uncleared margin rules through Phases 5 and 6 will significantly increase the universe of asset managers required to manage and source eligible collateral for their margin obligations, which will add to securities financing volumes as managers look to source cash and eligible collateral. Peer-to-peer trading across agent platforms offers access to cash and collateral

“As owners come to realise that the GPFA is about addressing beneficial owner and asset manager needs, acceptance and participation of membership has increased.”

- Mike Pramik, Ohio Public Employees Retirement System

upgrade trades to meet these expanding collateral needs.

“While the market platforms are adapting for scale, we have not seen a widespread increase in generic peer-to-peer transactions outside of some nuanced, bespoke arrangements,” says Smith. “The barriers to entry for buy side participants remain largely entrenched - infrastructure, credit, regulations, and best execution all create significant hurdles in creating an operational and risk framework acceptable to investment committees considering changing an institution’s point of access to liquidity.”

Where peer-to-peer has had more success is in the ability to price and transfer liquidity from different parts of an organisation to affiliates or other related entities. According to Smith this potentially has significant benefits from a liquidity pricing and liquidity risk perspective compared with the bank intermediation model that exists currently.

Many securities lenders believe that indemnification is a required component in their current securities lending programmes explains Jon Atkins, head of alternative financing, agency securities financing at J.P. Morgan.

“In many cases, asset owners and asset managers approve loan counterparties based upon their agent lender’s willingness to provide indemnification against counterparty (borrower) default,” he says. “In deciding whether to participate in peer-to-peer activity, asset owners and managers must determine whether they could be comfortable transacting with peers directly without the protection

of the agent’s indemnity for counterparty default.”

Direct activity

The expansion of activity directly between asset owners or managers and cash providers across tri-party repo platforms - without intermediation and indemnification by a bank or dealer, or default indemnification - is evidence that there is an increasing comfort in these securities financing transactions.

Atkins observes that asset owners are increasingly focusing on the overall cost of funding rather than the pure alpha generation from securities lending programmes.

“The opportunity loss of inefficient funding for margin obligations, excess cash management and working capital can significantly outweigh lending returns,” he notes. “Where funding spreads can be minimised and alternative, perhaps more stable, sources of liquidity identified, treasury managers have interest. Unsurprisingly, the topic of peer-to-peer therefore attracts significant attention.”

Atkins says J.P Morgan is not seeing asset owners developing new internal platforms to support peer-to-peer given the fixed costs involved and the prospect of mandatory regulatory change, especially in the US.

“So it is largely dependent on engaged asset managers to work with their existing bank providers to create infrastructure, data feeds, and reporting that works for their own binding constraints and regulatory requirements,” he concludes. ■

Making the most of peer-to-peer lending



John Templeton, managing director and global head of securities finance sales and relationship management at BNY Mellon explores some of the challenges facing the peer-to-peer lending market

How has the peer-to-peer lending market developed over the last 12 months?

There have been a number of factors that have spurred interest in the peer-to-peer market over the last year. But I'd say that the biggest factor has been the number of firms that have to comply with the uncleared margin rules, which require both sides of noncleared derivative trades to post initial margin at a third party custodian. There are times where clients find that the assets that they have in their account and they planned to use for UMR, even if they are liquid, aren't acceptable to post to their counterparty.

They are then faced with the choice to either change their investment strategy to hold more assets that are eligible, or see whether they could engage in what are commonly known as collateral transformation trades – which are just a type of securities lending trade.

The big question for the client is whether that transformation trade that takes place

because of UMR is best executed through a dealer's balance sheet or peer-to-peer. This is the point of analysis that a lot of clients are looking at now and analysing the relative costs.

Ultimately, a key part of an investment strategy is being optimally invested into that strategy – so if they have the ability to execute a transformation trade, that helps the client to achieve that goal – to have enough liquidity without having to liquidate. But if the cost of executing the transformation trades is higher than the expected return on the strategy, they'll opt to hold more assets that are always eligible with their counterparties, like US Treasuries.

This is why I think we are at a point where clients are analysing rather than executing on peer-to-peer – they don't yet know their needs post September 1 when their UMR obligations start and they need to determine at what point they will have to post collateral.

.....

“ I think we are at a point where clients are analysing rather than executing on peer-to-peer - they don't yet know their needs post September 1 when their UMR obligations start and need to determine at what point they will have to post collateral. ”

“ There are numerous examples of trades which consume more of a bank’s capital than is justified by the spread, and those trades are good places for clients to examine trading with a peer. ”

Have asset owners embraced the concept?

Peer-to-peer really isn’t new – we have seen these trades be executed for a long time. What we have always found is that there are more clients willing to engage through the agent lending construct because our clients have internal credit teams whose review process was built to examine rated entities and “peers” tend not to have those ratings because they don’t carry debt.

There’s a skillset and experience necessary to analyse a public pension plan, a sovereign wealth fund, an insurance company or asset manager that don’t have credit ratings. Banks (be they agent lenders or dealers) have a lot of experience in doing this.

So where we have seen success in this peer-to-peer mechanism is when our clients are leveraging BNY Mellon and we perform due diligence on their behalf, source demand from peers as borrowers, and then trade on behalf of clients who approve their peers. This makes the process function as BAU on the supply side for clients. On the demand side of the transaction, transacting in a peer-to-peer transaction can hold some differences vs trading through a dealer. For many clients on the demand side, they have looked at peer-to-peer but the benefits of retaining balance sheet access and the simplicity of execution in a variety of trade types has led to them to continue to trade through the banks.

Has it helped to generate a higher volume of transactions rather than simply redirect existing business?

In our experience, these trades are absolutely incremental rather than a redirection of business. One reason we believe that is if you

take this back to the base case – why are peer-to-peer trades being explored? They are being explored when the cost of accessing a bank’s balance sheet is higher than the value of the trade. There are numerous examples of trades which consume more of a bank’s capital than is justified by the spread, and those trades are good places for clients to examine trading with a peer.

A good example of this is what we’ve seen in the FICC sponsored repo market. The trades that are eligible in FICC’s CCP (US Treasury repo) don’t always make sense at all times for a bank to intermediate. By novating the trade to the FICC, both of the end users in the trade (the initial collateral seller and the cash investor) are able to complete the trade at a market level, without requiring the credit intermediation of a bank and receiving, instead, the credit intermediation of a CCP. Some would argue that sponsored repo isn’t peer-to-peer because of the FICC’s role, but we find it’s playing a similar role for clients’ looking to source liquidity without consuming dealer balance sheet.

Are agent lenders more relaxed about P2P than they were at the outset?

Peer-to-peer has never been a controversial topic for us - we have viewed it as our responsibility as an agent lender to go out and achieve for our clients the best returns we possibly can and that requires us to go through and do analysis on all sorts of borrowers. That’s why we’ve been engaged in peer-to-peer since the outset. It’s really a natural evolution in the agency lending space – being able to lend to an end user makes good sense from an economic perspective for our clients and from a risk perspective for us and the client. ■

Stronger together

Representatives of the London, Toronto and Boston chapters of the Women in Securities Finance (WISF) group offer an update on developments over the last 12 months.



Betsy Coyne - senior vice president, client relationship management eSecLending



Harpreet Bains - managing director, global head of product management for agency securities finance J.P. Morgan



Mary Jane Schuessler - director, equity finance global equity products BMO Capital Markets

What is WISF working on to support the securities finance industry acknowledge the role and impact of women in the industry?

Betsy Coyne: WISF hosted the opening keynote event at the IMN International Securities Finance & Collateral Management conference in Arizona in May. The discussion (and podcast for WISF Perspectives podcast series) featured behaviour change communication expert, Morgan Hillenbrand, who shared methods for advancing gender equality in male-dominated industries.

WISF members continue to participate in podcasts, which are all available via the WISF website and all major podcast services. Past topics include leading remotely, effective leadership, and self-advocacy.

We also publish a quarterly newsletter that highlights our events, accomplishments, and member updates and promote all this content to augment the networking opportunities of WISF and increase visibility of women in our industry.

I should also highlight the educational initiatives of our members. On International Women's Day in March, WISF and Vanguard participated in a discussion with high school students local to Vanguard's headquarters to discuss careers in the mutual fund and securities finance industry with a focus on the importance of distinguishing between excellence and perfection.

What kind of impact have you seen the pandemic have on how women work in the securities finance space?

Mary Jane Schuessler: I often hear how working from home has been a game changer for the work/life balance, especially when you have children in the mix. However, I am also hearing some nervousness about the future. There are many questions WISF is attempting to help answer through research, sharing of past successes, growing network initiatives, and general support.

Looking back at the past couple of years, what are lessons that you/your members have learnt?

Harpreet Bains: Realistically, it might be years before the full ramifications of the pandemic on our professional and personal lives are properly understood. A key lesson for me personally is more greatly appreciating the importance of leading with empathy and trust.

Covid has helped shine a light on the role that empathy plays in effective leadership. Hopefully, this is something that will continue to be valued by workplace cultures even beyond the pandemic.

BC: One of the lessons I learned was that I had not previously grown, nurtured or leveraged my network as much as I should have. I always focused on my job and my team, neglecting my personal development and exposure. I had been fortunate to have mentors who encouraged me to make time for networking, but personal development was always less comfortable to do.

WISF helped me to move outside my comfort zone, encouraged me to focus on my personal development and reminded me about the importance of leveraging my trusted resources.

How do you build effective networks in a sector which has also seen elements of remote working being introduced?

HB: The benefits of hybrid working have been spoken about at length, but this does not mean the end of the office. It's very important that women - and everyone - do not lose sight of the importance of teamwork, physical interaction and networking. To do this successfully means learning to network more smartly.

It may seem that there are plethora of events and gatherings taking place and trying to manage for these within a hybrid working pattern may be proving difficult, but reality is that you



“ There are many questions WISF is attempting to help answer through research, sharing of past successes, growing network initiatives, and general support. ”

Mary Jane Schuessler, BMO Capital Markets

.....

don't have to go to every event. In fact, 'over networking' can actually have a detrimental effect. Be selective and opt for those that will be of most value to you.

Finally, consider expanding your digital footprint and getting to know people on social media. Reading lengthy articles and papers can be challenge if you're time poor but short posts on LinkedIn can be more manageable, easier to engage with, and open up opportunities to connect with someone new and like-minded that you might otherwise not have reached through traditional methods.

What are you hearing from you members in terms of challenges they are facing but also opportunities they are seeing?

MJS: I often get asked how one can get involved especially when it comes to leading an event or a chapter. This is something we have discussed across all the chapter leads: the need for succession planning and bringing

those into the fold who want to take on more than just attending events.

Although women within the financial services sector have made enormous headway, we continue to hear from our members about challenges - especially when it comes to senior leadership roles. As chapter leads, we try and build events and activities around building your own brand and confidence to be well positioned for these roles.

HB: There is no doubt that the pandemic has brought about positive change for women in the workplace and helped dismantle some long-held barriers. The scaling up of flexible working practices has potential to be a real game changer, particularly helping unlock professional opportunities for women who juggle work and caring responsibilities.

The challenge now is how to focus on retaining these changes into the future and working towards stamping out cultural stigma that might mean these policies exist only on paper as opposed to fully embraced (across a spectrum of roles) in practice.

Another positive change that WISF members feel upbeat about is the fact that diversity, equity and inclusion has clearly gained more executive accountability in recent years. Within individual organisations it has moved from being an additional aspect of someone's job to being the sole responsibility of an executive who sees to it that it is an important part of the conversation at all levels of the organisation.

Across the securities finance industry, there is now much wider awareness of gender parity. This is good, because if we want to move the dial it begins with industry leaders recognising that there is a problem that needs to be fixed. The challenge is now making sure that we can collectively move this from well-intentioned discussions and one-off unconscious bias training to measurable impact and outcomes



“ One of the lessons I learned was that I had not previously grown, nurtured or leveraged my network as much as I should have. ”

Betsy Coyne, eSecLending

.....

that serve to improve the experience for marginalised employees.

We also need to remain mindful that diversity goes beyond gender. It is encouraging to see that the importance and need to bring different ethnicities and backgrounds into the conversation is growing.

Overall female representation in the industry is still not where we want it to be, but the black and ethnic footprint is even lower. We often hear that it is a pipeline problem but it is now time to unpack why that is the case and what specifically is hindering the entry of diverse talent into our hiring pipeline and/or impacting retention rates.

We have an opportunity to break away from the long-standing narrative of being a white, male dominated industry to one that is more aspirational for the newer generations. This will include evidencing that we are taking steps



“ Covid has helped shine a light on the role that empathy plays in effective leadership. Hopefully, this is something that will continue to be valued by workplace cultures even beyond the pandemic. ”

Harpreet Bains, J.P. Morgan

.....

towards levelling up and creating a fairer and more equitable workplace for all, and not just talking about it.

What is on the agenda in terms of projects and initiatives for WISF in 2022?

MJS: The Toronto chapter typically holds two events though the year with a focus on networking and building your own personal brand. With the impact of Covid in the past two years we added an additional community outreach event with the goal of supporting women in need.

This year we partnered with a charity, Yellow Brick House, which assists women and children

trying to escape violent situations. The Toronto chapter raised over C\$7,000 for the charity and spent most of a Saturday at the women’s shelter doing yard work and building a garden. The event was extremely rewarding and we hope to continue this as a yearly tradition.

Our event ahead of the Canadian securities lending conference was the first in-person event for many and again we focused on networking given we have had many new members join not only WISF but the wider industry.

HB: For the London chapter, our main priority this year is to focus on helping our members grow their connections. Having launched immediately before the pandemic, the networking component of our mission was the harder piece to manage as we grappled with ongoing lockdowns. That said it created an opportunity to rethink traditional networking and transform the way we make connections, using a hybrid of virtual technologies and/or in-person.

At the start of 2022 - following a successful pilot at the end of 2021 - we formally launched Grow Your Network, an initiative aimed at connecting our members on a one-to-one basis for short icebreaker introductions, making sure that we intentionally leveraged the breadth of diversity across the London chapter (gender, experience, grade, experience) when constructing the pairings.

We expect this initiative to run several rounds this year and subject to feedback, we aim to sustain it into 2023 hopefully with the continued assistance of members wanting to get more involved in WISF delivery.

We are also very excited about the ISLA conference in Vienna, where the Women in Securities Finance London Chapter hosted its first in-person networking event. In creating a spirit of sharing and inclusivity, the invite was open to all conference delegates - women and men - and was an opportunity to cross paths with someone new in an informal setting. ■

Agency Securities Finance

| Performance | Analytics | Governance

Unlock your portfolio's full potential, enhance returns and finance efficiently with customizable lending solutions linked to J.P. Morgan's global equity, fixed income and cash management capabilities. We offer full-service agency securities financing backed by over four decades of expertise, proprietary technology and advanced analytics and insights.



Contact your representative to learn how we can help or visit www.jpmorgan.com/securities-services

Securities lending opportunities in a rising rate environment



Michael Saunders, head of agency lending Americas at BNP Paribas Securities Services explores some of the opportunities that the rising interest rate environment has created within securities finance.

If we look at the overall securities financing market, approximately two thirds of all loan balances globally are against non-cash collateral – although that ratio is inverted in the US where cash collateral dominates. Despite the excess liquidity in the markets, compelling opportunities exist to capture excess return through the acceptance of cash collateral in securities lending transactions.

The Federal Reserve's reverse repurchase programme is reaching new highs on a daily basis, hovering in excess of \$2.2 trillion, highlighting the excess liquidity prevalent in the market. Despite the surplus of liquidity and spread compression, central banks are tightening monetary policy globally, which represents significant opportunities for sophisticated beneficial owners.

A rising rate environment, where some central banks have been very transparent about their plans for further increases, has led the forward market to anticipate upwards of 200 basis

points of Fed rate increases over the next nine months.

Cash collateral reinvestment

"If you are a beneficial owner participating in a securities lending programme, given the choice to transact against cash or non-cash collateral, I would be in favour of receiving cash collateral because the opportunities in the market are far greater," says Michael Saunders.

Beneficial owners opting to invest their cash collateral in typical money market instruments can capture some of that anticipated rate hike premium. It is an opportune time to implement a duration-mismatched programme, lending assets on a short-term basis while investing the cash collateral for longer tenors.

However, engaging in a duration mismatch strategy should be part of a cash reinvestment strategy, with beneficial owners remaining cognizant that funding conditions and basis mismatch can quickly erode the potential uplift.

“ If you are a beneficial owner participating in a securities lending programme, given the choice to transact against cash or non-cash collateral, I would be in favour of receiving cash collateral because the opportunities in the market are far greater ”

“ When beneficial owners are selecting an agent, they should take note of the experience of the team investing that cash collateral. They need to ensure opportunities will not be missed, and more importantly, that risks will be managed correctly ”

As for whether it is a concern that many of those working in the securities lending industry may have limited experience of working in a rising interest rate environment, we should acknowledge that the industry has made great strides in implementing various forms of automation and discovery, both in price and liquidity discovery.

There are numerous providers offering automated transaction and borrowing, and this has eased a lot of workload for experienced staff. Execution is only one of the variables needed to monetise opportunities in a tightening interest rate environment. There remains an imperative need to ensure the agent lender has the sophistication and knowledge needed to identify these mismatch opportunities and manage the risk accordingly.

Managing a cash reinvestment programme through a rate hike cycle

Experts in securities lending that have experienced rate hike cycles before will benefit from automation by being able to focus on anticipating market movements. Experienced lenders can optimise lending and reinvestment programmes to quickly monetise price dislocations, by looking at various metrics in the market such as interest rate futures or euro-dollar contracts, and pricing-in the probability of higher interest rates.

If you are looking to implement non-traditional cash reinvestment strategies, experience is important in terms of knowing how to manage a reinvestment portfolio in line with the guidelines of clients. Parameters such as the weighted average maturity and ample amounts of liquidity held can play a role in

seizing opportunities when they arise.

Putting the cash collateral to work both quickly and efficiently in order to monetise the market dislocation is critical and requires a proper management of the reinvestment portfolio.

When beneficial owners are selecting an agent, they should take note of the experience of the team investing that cash collateral. They need to ensure opportunities will not be missed, and more importantly, that risks will be managed correctly.

While the experience of the agent lender is obviously key, the knowledge of the client is also important as they generally keep a high level of control on cash collateral reinvestment activities. Clients need to know when to restrict activities, or not, to maximise the benefits of their lending programmes.

At the end of the day, it all comes down to what the client is expecting. Sophisticated beneficial owners will push boundaries to maximise revenues while other participants are seeking the market return to generate incremental income on their idle assets.

An agent lender that has experience facing market volatility should be more effective with P&L generation and risk mitigation in the anticipated upcoming market conditions.

Increased directional strategies

The impact of higher interest rates and the divergence in pace of central banks tightening will translate into increased volatility. Typically, this volatility presents opportunities for securities lending participants.

The data from industry aggregators highlights the increased demand for companies linked to sectors that are sensitive

“ I would venture to say that companies linked to consumer finance – whether they are credit card companies, mortgage lenders or payday loan-type providers – will be impacted by a change in the ability of consumers to pay back their loans due to higher interest rates ”

to higher rates, such as consumer finance, mortgage lenders and credit card companies. These sectors have started to show signs of demand and will eventually be under pressure as rates continue to rise and the consumer becomes challenged with the ensuing higher financing charges.

“I would venture to say that companies linked to consumer finance – whether they are credit card companies, mortgage lenders or payday loan-type providers – will be impacted by a change in the ability of consumers to pay back their loans due to higher interest rates. These companies may see an increase in short interest or elevated borrows,” says Saunders.

Currency arbitrage opportunities

Another topic of interest for the securities lending industry is whether there will be increased opportunities for currency arbitrage given central banks are raising rates at different levels and paces.

While there is a globally coordinated central bank tightening cycle underway, the Fed is moving at a faster pace than the central banks of other developed countries. This leads to increased strength in the US dollar and typically creates cross-currency basis widening.

For beneficial owners engaged in collateral transformation and specifically cross-currency transformation, we can expect increased opportunities in the months ahead.

“One example of this is lending US Treasuries and accepting Japanese government bonds, or lending US Treasuries and accepting UK gilts. We anticipate these spreads will widen from the historical average that we have seen over

the past year or so. This will happen as a direct result of the FOMC tightening having a pace that is faster than many other central banks,” says Saunders.

Whether these arbitrage opportunities persist or not and whether disparity in central bank monetary policy continues through the remainder of this year and beyond remains to be seen.

Depending on your global monetary policy outlook, it is anticipated that the Fed will be raising rates through to the middle of 2023 with the target being somewhere between 3.50% and 4.0%. If you fast-forward a year from now, to June 2023, and you have a US interest rate of at least 3.75% and the Bank of England is at 2%, that arbitrage opportunity should remain.

However, it is not as simple as saying ‘the interest rate in the US is at 3.75% and the interest rate in the UK is at 2% so there is an immediate arbitrage opportunity’ – there is not that direct correlation. But we can still assume that this cross-currency basis arbitrage should be around for the next 12 months.

BNP Paribas Securities Services’ solutions

In the US, BNP Paribas Securities Services allows clients to take advantage of the trends highlighted above through its agency securities lending programme and its directed agent repo liquidity solution (cash reinvestment). Implementing the appropriate strategy is of course at the discretion of each individual beneficial owner. However, it remains imperative clients are cognizant of the opportunities presented in a rising interest rate environment. ■

TO ACCELERATE CHANGE, WE CONNECT YOU TO EXPERTS AROUND THE WORLD.

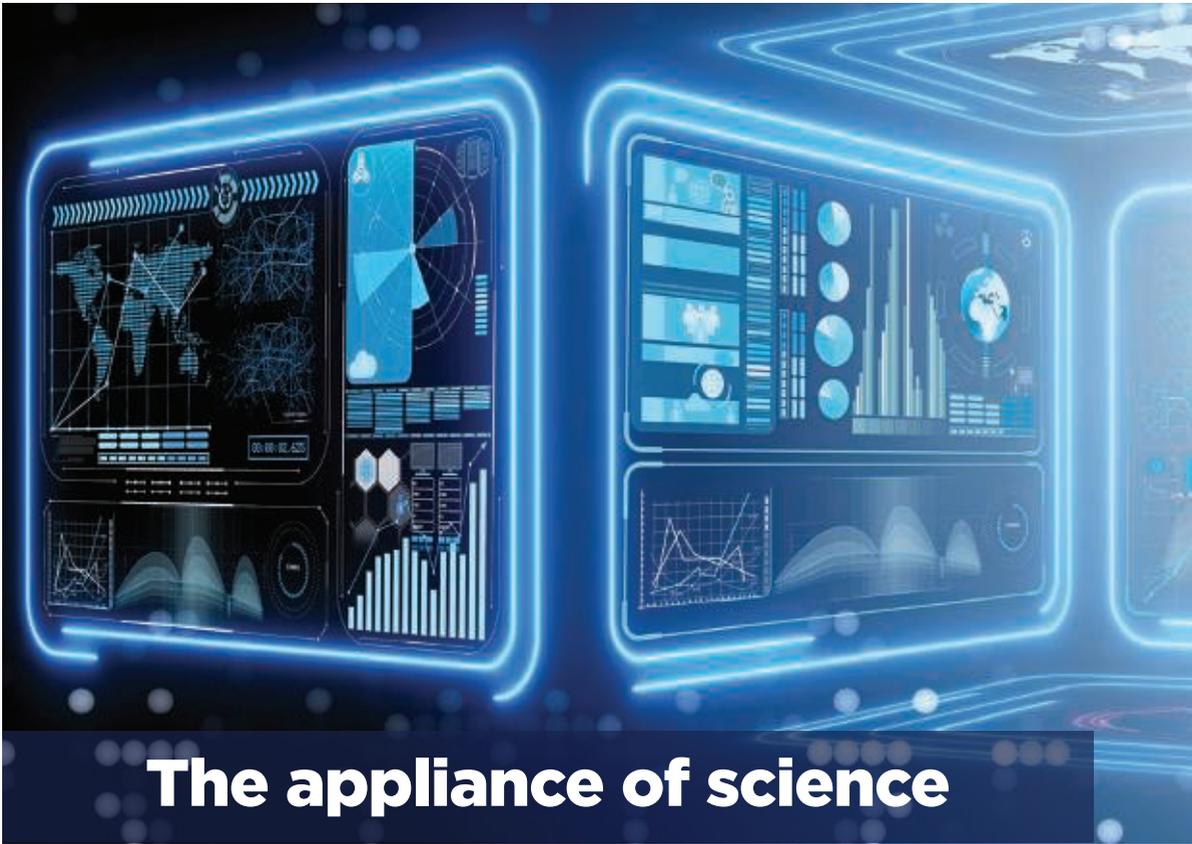


At **BNP Paribas Securities Services**, we support your global ambitions and sustainable investment strategies. Our experts around the world provide you with the connectivity, technology and local knowledge you need in today's fast-changing world. **Getting to a better future faster, together.** **#PositiveBanking**



BNP PARIBAS

The bank
for a changing
world



The appliance of science

Paul Golden looks at the opportunities for regulatory technology growth in the securities lending space and the aspects of compliance where technology can have the greatest impact in terms of speeding up processes, reducing errors, and keeping pace with regulatory change.

Regulatory technology or regtech (a subset of fintech that leverages new technologies such as cloud computing, big data, machine learning and natural language processing to address regulatory challenges within the financial industry) is one of the fastest growing segments of the technology market.

A report published earlier this year predicted that the global regtech market would expand from \$7.6 billion in 2021 to \$19.5 billion by

2026 across multiple areas including risk and compliance management, identity management, regulatory reporting, fraud management, and regulatory intelligence.

When asked which areas of regulatory technology offer opportunities for growth in the securities lending space and the areas of compliance where technology could have the greatest impact in terms of speeding up processes, reducing error and keeping pace



“ Regulation often is a driver to implement changes, automate processes, drive efficiencies, and enable firms to prioritise their IT budgets. ”

Bob Zekraus, Pirum

with regulatory change, Bob Zekraus, chief operating officer and head of the Americas at Pirum notes that regulation often is a driver to implement changes, automate processes, drive efficiencies, and enable firms to prioritise their IT budgets.

Regulatory drivers

“We have seen this with other regulations - most recently CSDR, which is driving improved post-trade processes not just for the European markets impacted by CSDR, but in all markets for our clients,” he says. “Additionally (although not a direct requirement of the regulation itself) with the advent of SFTR in the EU as well as the reporting services we offered,

we saw a lot of firms review and ultimately improve their daily processing of securities financing transactions via our existing automation of marks, returns, and other processing functionalities.”

This was necessary to improve the quality of the reports being submitted to regulators. With proposed SEC rule 10c-1 - Reporting of Securities Loans looming on the horizon for US participants, Pirum expects firms to be looking at how they will deal with the challenge of reporting as well as how they ensure the quality of what they are reporting.

Tracking of regulatory requirements by jurisdiction is one of the areas to watch because these are always subject to



“Straight-through processing or STP can best be achieved with no or low code automation that is accessible to end users who are less technical-minded.”

Aman Thind, State Street

change and present a risk to global financial institutions operating simultaneously in and across many locations.

At the same time, collateral management is increasingly complex and support for multiple asset types as collateral and especially automated collateral management will likely see strong growth.

Automisation opportunity

That is the view of Aman Thind, global chief architect at State Street, who notes that because securities lending has historically been a heavily manual process there is significant opportunity for systemisation to improve efficiency and mitigate risks.

“Straight-through processing or STP, for example, can best be achieved with no or low code automation that is accessible to end users who are less technical-minded,” he says. “Beyond that, machine learning pattern recognition can help predict next required actions, although it must be aligned with regulatory model documentation requirements on explainability.”

In addition to STP, consolidated data processing of both internal and external sources - and the ability to identify all forms of a given entity and linked entities - will result in reduction of errors and enhance quality controls overall.

“To ensure regulatory adherence, data security and segregation best practices must also be in place,” adds Thind. “Finally, any application should have a high degree of configurability to adjust flexibly to changes in regulatory and market requirements, and ideally be able to integrate seamlessly with other in-house and vendor tools.”

Rising reporting

Regulatory reporting requirements have increased significantly, and there is no sign of this trend easing. Although it is still early in the process, the SEC 10c-1 proposal will dramatically impact market participants and is expected to bring a much greater level of transparency to the securities lending marketplace.

As EquiLend has two entities registered with and regulated by the SEC and which are members of FINRA, it is well placed to act as a reporting agent should the proposed rule come into effect observes Nancy Allen, head of



Nancy Allen, EquiLend: “We have the technology in place to support intra-day, end of day or T+1 reporting, which is already utilised by many participants in the securities lending market”

data & analytics.

“We have the technology in place to support intra-day, end of day or T+1 reporting, which is already utilised by many participants in the securities lending market,” she says.

Distributed ledger technology (DLT) and smart contracts could - if properly adopted - create a near perfect environment to sustain growth while maintaining operational risk and generating efficiencies suggests Dexter Gall, associate director securities finance at RBC



Dexter Gall, RBC Investor & Treasury Services:

“Some of the investments made by the International Securities Lending Association, International Capital Market Association and International Swaps and Derivatives Association in terms of standardising via the common domain model should make markets more attractive for innovation”

Investor & Treasury Services.

“Some of the investments made by the International Securities Lending Association, International Capital Market Association and International Swaps and Derivatives Association in terms of standardising via the common domain model should make markets more attractive for innovation,” he concludes. “Evidence of that can be seen already with electrification of the negotiation and retention of master agreement terms.” ■

Decoding new guidance on ESG investing



In January 2022, the Canadian Securities Administrators (CSA) released new guidance regarding environmental, social and governance or ESG funds in Canada.

David Petiteville, director of regulatory solutions at RBC Investor & Treasury Services and **Lynn McGrade**, partner at Borden Ladner Gervais LLP discuss the impetus for the guidance, how fund managers are impacted, and potential next steps.

Explosive growth in ESG-related investments prompts new guidance from regulators

The CSA Notice¹ establishes disclosure requirements for investment funds as they relate to ESG considerations, particularly funds that use ESG strategies or whose investment objectives reference ESG factors. The notice - which applies to regulatory documents and sales communications - provides guidance about complying with existing requirements and recommends best practices for ESG disclosure.

The CSA released the notice in response to significant growth in the value and number of ESG funds in Canada, and investor desire for 'clear, consistent and comparable' fund disclosure.

The Investment Funds Institute of Canada has reported a dramatic increase in ESG investing over the last two years². The CSA notice comments that by April 2021, the value of sustainable funds in Canada had grown by 160% since the start of 2020, and the number of sustainable funds increased to 156 compared to 105 at the same time the prior year.

Coincident with this significant growth in

ESG funds, Canadian investors are increasingly looking for reporting on how funds have performed on their ESG objectives to complement investment performance reporting.

"The goal of the notice is to prevent greenwashing where there could be an inadvertent misconception or confusion for investors about what they are actually buying," explains Lynn McGrade.

As a result, the notice requires funds to describe their ESG strategies in plain language, using clear and comprehensive explanations of ESG terms.

Review required: are you impacted?

The notice is based on existing securities regulatory requirements and does not create any new legal requirements or modify existing ones. It came into effect upon release and applies to all funds, including those that have ESG terminology in their name, objectives or strategy.

Managers should consider reviewing the notice "as it applies whether or not you have existing ESG funds, plan to launch new ESG funds or have funds without ESG components," says David Petiteville.



Investor &
Treasury Services

Specialist Expertise Assured Financial Strength

Combining specialist expertise alongside innovative technology, RBC Investor & Treasury Services delivers asset servicing solutions to support asset and fund managers in achieving their investment, market and product expansion objectives.

To discover how we can help, visit rbcits.com

Distribution Services | Securities Processing & Administration | Information Management | Transaction Banking | Optimisation

© Copyright Royal Bank of Canada 2022. RBC Investor & Treasury Services™ is a global brand name and is part of Royal Bank of Canada. RBC Investor & Treasury Services operates primarily through the following companies: Royal Bank of Canada, RBC Investor Services Trust and RBC Investor Services Bank S.A., and their branches and affiliates. In Luxembourg, RBC Investor Services Bank S.A. is authorized, supervised and regulated by the Commission de Surveillance du Secteur Financier (CSSF), and jointly supervised by the European Central Bank (ECB). In the United Kingdom (UK), RBC Investor & Treasury Services operates through RBC Investor Services Trust, London Branch and Royal Bank of Canada, London Branch, authorized and regulated by the Office of the Superintendent of Financial Institutions of Canada. Authorized by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available on request. RBC Investor & Treasury Services UK also operates through RBC Europe Limited, authorized by the Prudential Regulation Authority, and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Additionally, RBC Investor & Treasury Services' trustee and depositary services are provided through RBC Investor Services Bank S.A., London Branch, authorized by the CSSF and ECB, and subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available on request. RBC Investor Services Bank S.A. maintains a representative office supervised by the Federal Reserve Bank of New York. RBC Investor Services Trust (Australian Branch) is licensed and regulated by the Australian Securities and Investment Commission, Australian Financial Services licence number 295018. Details about the extent of our regulation by the Australian Securities and Investment Commission are available on request. RBC Investor Services Trust Singapore Limited is licensed by the Monetary Authority of Singapore (MAS) as a Licensed Trust Company under the Trust Companies Act and approved by MAS to act as a trustee of collective investment schemes authorized under S286 of the Securities and Futures Act. RBC Investor Services Trust Singapore Limited is also a Capital Markets Services Licence Holder issued by MAS under the Securities and Futures Act in connection with its activities of acting as a custodian. RBC Offshore Fund Managers Limited is regulated by the Guernsey Financial Services Commission in the conduct of investment business. Registered company number 8494. RBC Fund Administration (CI) Limited is regulated by the Jersey Financial Services Commission in the conduct of fund services and trust company business in Jersey. Registered company number 52624. RBC Investor Services Bank S.A. is a restricted license bank authorized by the Hong Kong Monetary Authority to carry on certain banking business in Hong Kong. RBC Investor Services Trust Hong Kong Limited is regulated by the Mandatory Provident Fund Schemes Authority as an approved trustee. Royal Bank of Canada, Hong Kong Branch, is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission. This material provides information on the services and capabilities of RBC Investor & Treasury Services. It does not constitute an offer, invitation or inducement with respect to any service or financial instrument. RBC Investor & Treasury Services' services are only offered in the jurisdictions where they may be lawfully offered and are subject to the terms of applicable agreements. This material is for general information only and does not constitute financial, tax, legal or accounting advice, and should not be relied upon in that regard. Links to external websites are for convenience only. RBC Investor & Treasury Services does not review, endorse, approve, control or accept any responsibility for the content of those sites. Linking to external websites is at your own risk. ® / ™ Trademarks of Royal Bank of Canada. Used under licence.

“ Given the guidance, are your existing and new funds in the categories you would like them to be? If not, consider what changes are needed to position your funds to meet your goals. ”

- Lynn McGrade, partner at Borden Ladner Gervais

The notice also introduces the following new terminology:

- ESG funds reference an ESG factor as part of the investment objectives
- ESG strategy funds use ESG strategies but may not have ESG-related terminology in their name or objectives
- ESG-related funds is a catch-all category that includes both ESG funds and ESG strategy funds

Practical steps to position your funds in the ESG context

The guidance covers multiple areas of ESG-related disclosure, including investment objectives and fund names, fund types, investment strategies disclosure, proxy voting and shareholder engagement policies and procedures, risk disclosure, suitability, continuous disclosure, and sales communications.

Due to the range of areas included in the notice, managers should ensure they review how the guidance may impact their funds.

McGrade says fund managers can follow a three step process for responding to the guidance contained in the notice:

1. The first practical step is for managers to ensure they are familiar with the guidance by reviewing the notice in detail
2. Next, fund managers should audit their existing products to see where and how they fall into the new guidance - do they have ESG funds, ESG strategy funds or ESG-related funds
3. Finally, once managers have identified the categories their funds fall into, they should perform a gap analysis by reviewing their

website and marketing materials to check whether updates are required to comply with the notice

“Once this process is complete, managers should step back and confirm where they have landed,” says McGrade. “Given the guidance, are your existing and new funds in the categories you would like them to be? If not, consider what changes are needed to position your funds to meet your goals.”

What to expect next as global ESG investing trends accelerate

As ESG investing becomes more mainstream, regulators are expected to increasingly align Canadian standards to global requirements according to Petiteville.

However, the lack of guidance from the CSA on standard terminology can present challenges for Canadian fund managers who are operating in a global context. As a result, he notes that common definitions and taxonomy may be on the agenda for future development.

Petiteville adds that managers should expect to see increased harmonisation of the measurement of ESG-related performance, potentially including a regulation to establish rating, ranking and scoring measurement standards. He concludes that more enforcement - whether from the CSA or provincial securities regulators - may also be on the horizon. ■

Sources:

1. Canadian Securities Administrators, CSA Staff Notice 81-334 – ESG-Related Investment Fund Disclosure, January 19, 2022
2. Investment Funds Institute of Canada, 2021 Investment Funds Report, January 2022

User collaboration goes down well stateside



David Raccat and **Joseph Seroussi**, co-founders of Wematch look at how the platform has developed since its launch in North America and the importance of working closely with users.

Following its launch in 2017, Wematch quickly signed up a large proportion of securities finance market participants in Europe. This success encouraged the founders to roll out their product in North America.

Using a similar roadmap and having looked carefully at the specific characteristics of the North American market, the platform was launched in the US in October 2020 with the first group of dealers using the platform for equity swaps.

“We are now in a situation where market traction is very promising,” says David Raccat. “We have been talking to many clients and dealers who are starting the process of joining our community, and our team on the ground ensures that these clients are able to use the platform in a seamless way for the best user experience.”

.....

“ By ensuring there is a full match between what the buyer and seller are seeing in the platform we minimise the risk of a fail or a mismatch ”

- David Raccat, co-founder Wematch

The initial focus has been on equity swaps for US equities, but Wematch is currently looking at increasing its product group along the same lines as it did in Europe by adding securities lending into the mix. “We are working on this product with the objective of releasing it in North America over the coming months,” adds Raccat.

Workflow addressed

Workflow is the key issue the platform helps these clients address, providing a digital solution which allows them to minimise operational, compliance, conduct, and execution risk.

“Everything we do is to ensure that the data managed by our clients in the platform is systematically matched,” explains Raccat. “By ensuring there is a full match between what the buyer and seller are seeing in the platform we minimise the risk of a fail or a mismatch.”

Connectivity is another important element of the offer. “By using our API protocols we ensure minimal manual processing and keying,” he says. “Where we receive the data from the client automatically, we process that information into the platform and send it back to the clients through our API connectivity.”

Joseph Seroussi explains how Wematch

leverages agile technology to adapt to each client's needs. "We are connected on a single network that allows exchange of data sets between participants within and outside the organisation," he says. "We can also manage internal communication between, for example, sales and trading teams."

The approach used in the North American market has been similar to the trusted European model in terms of collaborating with product users.

Powerful model

"Our model is very powerful - whatever we do with one client is available across the entire community, which continues to grow," says Seroussi. "It is a collaborative product development approach which gets the entire market to move onto a digital platform collectively."

"What has enabled us to gain traction in this market is the continuous evolution of the product," he adds. "Since its launch it has evolved because the community is growing and clients have specific needs/ideas and new ways of handling workflow."

Wematch continues to onboard new clients and has a number of significant developments in the pipeline that will ensure volumes continue to increase, adds Seroussi, who is relocating to the US to help further develop the platform's local support team.

In addition to working on solutions and integration, a very important dimension of what the company is doing is about the community.

"We are building communities," observes Raccat. "The way we work is extremely collaborative and our users really like the fact that we work with multiple dealers, banks, sponsors, and partners, which allows us to develop a product that is state of art and (through ongoing development) fits extremely well with the community."

“ Our model is very powerful - whatever we do with one client is available across the entire community, which continues to grow ”

- Joseph Seroussi, co-founder Wematch

"We are coming to a point where we have built the product with very proactive tier-one players," he adds. "So other market participants joining the programme now are benefiting from the development work we have been doing with their peers over the last few years."

Multiple interactions

Raccat refers to a way of working that reflects not only multilateral interactions between banks or dealers, but also internal interactions - addressing the complexity of the workflow between internal teams or trader to trader, trader to sales, or sales to client.

"Our solutions portfolio continues to grow," he adds. "We expect to release them to the whole community because these solutions streamline, facilitate and digitise workflows that can otherwise be manual, risky and cumbersome."

As Seroussi puts it, firms that used to do business via emails, chats and spreadsheets now have access to a much stronger, more flexible and automated alternative around this workflow.

"They will still have conversations to discuss relationships and business, but everything that could be considered 'heavy lifting' - files, operations, calculations - is available on the system, which is much more efficient, saves them a lot of time, and reduces stress on the business," he concludes. ■



Did you really get
the **best match** today?

wematch.live

At **wematch.live** securities financing we offer you a new way to share interests and to facilitate negotiation and dealing on TRS, REPO and SBL,
ensuring you always get the best possible match in a fully compliant environment.

Our web-based platform is hosted on a secured and real time application **anticipating expected regulatory requirements** around increased transparency, liquidity, matching and reporting. Its usage is **very intuitive and flexible.**

In your best interest

 wematch.live

 contact@wematch.live

 [wematch.live](https://www.linkedin.com/company/wematch-live)



Mixed views on deadline for settlement change

Market participants are generally in accord over the merits of moving to T+1 in the US, but concerns remain about the timeframe for achieving this switch.

From Pirum's participation in industry working groups (and as it relates to securities lending activity) the consensus of market participants is that the proposed deadline of mid-2024 for moving to T+1 in the US is an appropriate and natural progression to the continuing operational advancement and efficiency of US market settlements observes Bob Zekraus, the firm's chief operating officer and head of the Americas.

"That being said, there is an appreciation and acknowledgment that more work needs to be done to harmonise the market for a move to T+1 settlement," he says. "The move

to T+2 five years ago was more behavioural in nature, whereas the move to T+1 is much more technical and thus requires more time to analyse operational processes with the focus on recalls, affirmation, and increased emphasis on real time automated connectivity between lenders and borrowers compared to the current outdated model of batch processing."

Zekraus observes that market participants are exploring both existing facilitators and areas of development to help realise the future changes to market structure in an accelerated settlement cycle.



“The consideration for clients to look at the holistic events on the lifecycle of transactions has become of greater importance as businesses look to better manage and mitigate risks and exposures,” he says.

Recall considerations

From a recall perspective, the action for the lender to notify and the ability for the borrower to receive, consume and process

“ There is an appreciation and acknowledgment that more work needs to be done to harmonise the market for a move to T+1 settlement. ”

Bob Zekraus, Pirum

recalls automatically become paramount given the shortened settlement cycle and eroding timeline to action, source/cover and collateralise obligations as required.

However, it is also intrinsically linked to having straight through processes and automation for additional post-trade events such as mark-to-markets, returns/call backs, contract compare, fund switches and loan reallocation, says Zekraus.

“It is the client participation, budget, and prudent risk management appetite to enhance operational efficiency and move off manual processing that will ultimately transform the market ecosystem by reducing risk from antiquated processes,” he adds.

According to Zekraus, market leaders, service providers, vendors and clients all agree that the industry has a long way to go before having the ability to realise a change of the magnitude of T+0. “The application and demonstration of further technology enhancements will drive the push for real time gross or periodic same day netted settlements in the markets,” he says. “The pragmatic approach for risk mitigation and appetite will continue to drive change - we feel it is a walk before you run situation.”

“ The technology is available, but requires changes as well as increased utilisation and integration of existing tools to be better prepared and achieve desirable outcomes. ”

Dexter Gall, RBC Investor & Treasury Services



Mike Norwood, EquiLend: “While from a trading perspective shortened settlement cycles are a benefit in that they reduce counterparty risk and lower margin costs, recalls in particular become an issue given the lack of real time sell notifications across the industry.”

Critical processes

More time is always preferable, especially when the change has a direct impact on day-to-day activities such as settlements that feed into other core and critical processes such as the production of NAV and foreign exchange. It would be ideal if T+1 was the only major item that participants had to attend to, but this is not the case.

That is the view of Dexter Gall, associate director securities finance at RBC Investor & Treasury Services, who notes that most market participants - in conjunction with various fintech partners - commenced efforts ahead of CSDR.

“The technology is available, but requires changes as well as increased utilisation and integration of existing tools to be better prepared and achieve desirable outcomes,” he says.

Gall describes T+0 as a great goal to aspire to but suggests the extent of the benefits is unclear when balanced against the investment required. “Most securities finance transactions conducted in North America are on a T+0 basis and extension to other parts of the financial system would likely require technological adoption such as distributed ledger technology,” he adds.

There is a fair amount of trepidation related to the implementation of T+1 as a result of the compressed timelines in the post-trade processes according to Mike Norwood, head of trading solutions at EquiLend.

“However, in general market participants can see the broader benefits,” he says. “While from a trading perspective shortened settlement cycles are a benefit in that they reduce counterparty risk and lower margin costs, recalls in particular become an issue given the lack of real time sell notifications across the industry.”

Acceleration benefits

Considering the meme stock phenomenon from last year and the increased volatility across the market seen throughout the first half of this year, the benefits of accelerated settlement are as important as ever as the focus on costs of capital and balance sheet/RMA concerns are becoming increasingly prevalent.

An appropriate level of automation is in place to facilitate shortened settlement cycles says Iain Mackay, EquiLend’s head of post-trade solutions.

“There are technical solutions available now for participants to embrace and the priority should be with them to understand how they can maximise usage,” he adds. “Managing your positions whilst the trade is open will be crucial to ensure there are no breaks which could impact the return leg settlement. Leveraging unified comparison tools will be essential.”

“ A move to T+0 has been widely discussed, but we think that this is not the right time given the substantial increase in complexity and disruption of products and process. ”

– Chris Rowland, State Street

When asked how market participants feel about the proposed deadline of H1 2024 for moving to T+1 in the US, Chris Rowland, head of custody product at State Street suggests a more realistic date would be over a three day weekend in September 2024 (Labor Day weekend) or May 2024 (Memorial Day weekend).

“In fact, T+1 was a major topic of discussion at the DTCC advisory council quarterly offsite in May and many members share our concern about the compressed timeline,” he says. “We feel that the industry would need sufficient time to plan for, implement and test changes to our systems, operations, policies and procedures, and also to engage in outreach and education to our client base.”

Potential dislocations

Rowland says market participants accept there is a need to make wholesale changes to the existing trade flows and practices and that there is a considerable industry support for moving to T+1, but also warns of concerns on potential dislocations in US markets focusing on ETFs, securities lending, FX funding challenges and increased settlement fails.

“One of the considerations we will need to address in planning efforts are changes to trade matching systems and processes, tighter deadlines for the receipt of client trade instructions and the resolution of any potential pre-trade problems, and the implications of T+1 settlement for various asset servicing functions such as the processing of corporate action events, income distribution and cash funding requirements,” he says.

“The implementation of T+1 settlement will also require a reassessment of existing industry processes in foreign exchange, securities lending markets, cross border trading and the operational model for exchange traded funds.”

Rowland believes T+1 can be achieved with existing systems and processes, but that the move is both a market structure and a technology compression event as it broadens what and who will be impacted in the marketplace.



Iain Mackay, EquiLend: “There are technical solutions available now for participants to embrace and the priority should be with them to understand how they can maximise usage”



Colleen Stapleton, MarketAxess: “There are technical solutions available now for participants to embrace and the priority should be with them to understand how they can maximise usage”

“A move to T+0 has been widely discussed, but we think that this is not the right time given the substantial increase in complexity and disruption of products and process,” he adds. “While conceptual problems can potentially be resolved by agreement among the various industry players, the breadth and complexity involved with same day settlement has wide ranging implications for the entire financial system.”

Same-day settlement would require a fundamental overhaul of the existing clearing, payment and settlement ecosystem for the US market and demand wide scale use of emerging technologies, such as digital ledger technology and instantaneous or near instantaneous payment functionality, to drive further automation and efficiencies.

Industry challenges

While the securities finance community recognises the expected benefits of a move to T+1 settlement in the broader equity market, it presents particular challenges to the securities lending/borrowing business.

The potential for timing mismatches between settlement of client sales when stock is on loan and loan recalls from borrowers becomes more acute in a reduced settlement cycle environment. Providers may need to look at earlier notifications of sales by fund managers and shorter recall timeframes between lenders and borrowers to minimise the impact on settlement rates says Dane Fannin, global head of securities finance for Northern Trust.

“The T+1 effort will require changes from borrowers, lenders, technology vendors, investment manager and clients to develop more straight-through processing as well as changes to practices such as sales notifications and confirmations/affirmations,” he says.

Fannin observes that improved systems functionality (internally and externally) and stronger STP between fund managers, lenders and borrowers would be beneficial. Involvement of service providers is also important as the lender-borrower community will require extensive and effective utilisation of tools for handling recalls.

“We see demand for T+0 coming primarily from the front office as a risk management measure from a liquidity and exposure risk perspective,” he adds. “For the back and middle office, changing to T+0 would be a much heavier lift, requiring some key rule changes and revamping of the current settlement model, whereas T+1 can be accommodated by practice changes and some automation of current models.”

System requirements

“I would say the securities lending/borrowing community will not be in a position to support

T+0 until there is a significant uptick in system capabilities and an ability by market participants to deal with near-real time data in an effective manner.”

Outright US Treasury transactions have been settling T+1 and overnight term repos settle same day on the open leg (T+0) explains Colleen Stapleton, product manager match products - cash and repo at MarketAxess.

It is a settlement cycle we have seen in some parts of the market but as all fixed income products move towards T+1, any participants who have not funded their technology will be in a tough spot, which is why it is important to start building now, she says.

“The 2024 deadline seems like a long time away, but it will really be here in no time. Now is the time for analysis, planning and budget allocation to close out the remainder of the year, while 2023 should be allocated to development followed by wrapping up testing and eventual go-live in 2024,” adds Stapleton.

“Firms that haven’t begun their automation and STP journeys are at a disadvantage to firms who already have connectivity and standard processes established with STP tools reducing and removing manual work while shortening the time to affirmation and confirmation and settlement readiness.”

Economic considerations

On the question of whether current market conditions are conducive to the move to shorter settlement, she suggests the economic outlook - of a short to medium term bear market - could prevent funding going into technology as market participants attempt to secure their bottom line, which would negatively impact any move towards shorter settlement.

“However, as the Fed aggressively raises interest rates to combat inflation, fixed income products could look more attractive than they did before (due to higher yields) and could



“ We see demand for T+0 coming primarily from the front office as a risk management measure from a liquidity and exposure risk perspective. ”

Dane Fannin, Northern Trust

.....

affect the volumes traded from a repo and US Treasury perspective,” says Stapleton. “It is therefore important for market participants to be prepared technologically to efficiently confirm, match, and settle these transactions if trading volumes were to rise.”

She reckons there will be limited appetite for T+0 until T+1 is working efficiently and that although this topic has been covered in various meetings, current discussions just raise awareness.

“Funding and revamping legacy platforms to meet the challenge is what will determine the market’s ability to move towards a T+0 cycle,” concludes Stapleton. “If the changes required are made over the next year and we are no longer talking about fax confirmations and end of day batches in 2024, then T+0 won’t nearly be as intimidating as it seems today.” ■

The evolution of the stock loan industry



Matthew Wolfe and **Oberon Knapp** from the Options Clearing Corporation (OCC) look at the evolution of the stock loan industry.

Matthew Wolfe is executive director, Renaissance clearing at OCC. He starts by recalling what the stock loan industry looked like when OCC created the stock loan programme in 1993.

“Market makers managed risk in their options positions through buying and selling stock or by lending and borrowing to hedge that exposure,” he explains. “However, back then we didn’t have visibility into the loans and the borrows, and we had a couple of situations where we discovered the risk in the market maker’s account would not have been as high had we known about their stock loan positions.”

Hence the name hedge - OCC treated it as a programme for those market makers to register their loans and borrows as a hedge against their options positions.

From your experience working with the firm, what have been the key development/evolutions in that service?

“It started as a risk management tool and in the years leading up to the financial crisis, we started to see balances growing much faster than they had previously. One of the primary motivations for that growth was credit disintermediation, where OCC steps in and becomes the counterparty, the lender to the borrower and the borrower to the lender.

“What was happening in the build up to the financial crisis was that firms were reaching their risk limit with counterparties and found that their internal risk management teams were much more willing to let them trade larger sizes if OCC was the counterparty.

“There was another fundamental shift that happened post Dodd-Frank and Basel after those regulations introduced requirements for regulatory capital and incentivised clearing. Firms had greater requirements to post capital which ate up a lot of their balance sheet, so they came to OCC more so for our 2% risk weightings, which was another accelerator in the growth of our programme.”

What have you had to do in terms of changing your offering/strategy in the market?

“Our system and how we approached it naturally allowed that migration to occur with no real changes on our part. We were becoming the borrower to the lender and lender to the borrower from day one, so that credit disintermediation always existed - it just wasn’t the primary factor.

“Then post-Dodd-Frank the regulators imposed the 2% risk weighting for CCPs, so it was just in the calculation of the firms’ regulatory requirements and we didn’t have

OCC Stock Loan Programs

Key Benefits

- Counterparty disintermediation
- Expanded credit and trading allowances for cleared activity
- Risk weighted asset savings of approx. 95% compared to uncleared stock loans
- Margin offset
- Automation and streamlined operations

79 125B

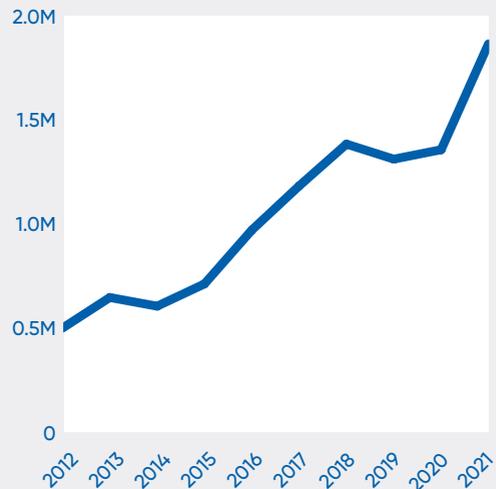
HEDGE LOAN
PROGRAM
MEMBERS

AVERAGE DAILY
LOAN VALUE
AT YEAR END 2021

Annual Notional Value of Loans



Annual New Loan Transactions



For more information about OCC's Stock Loan Programs, visit www.theocc.com

to make any changes in either our systems or how we approached the market. It shifted the discussion a little, but it didn't require much work on our part."

How would you characterise the current status of the stock loan industry?

"Our programme has continued to grow significantly. For example, through April we had a 34% increase in transactions over April 2021 and a 15% increase in our daily average loan value, so clearly there is continuing demand for a clearing service. What we are seeing in the industry is a push towards additional ways to alleviate balance sheets, whether that is through expanding the participants that can be clearing members, non-cash or other service enhancements that can help reduce regulatory capital requirements."

Oberon Knapp joined OCC earlier this year to take on the role of executive director securities lending. Prior to joining OCC, he was global head of product and investment operations at Brown Brothers Harriman (BBH) where he provided a modular and interoperable operating environment for asset owners and asset managers.

He was previously responsible for the global product and algorithmic trading development for BBH's securities lending franchise. Other prior roles include managing director at eSecLending, and managing director and co-head of the global account management group at State Street.

"The last 25 years of my career have largely been in the buy side of the securities lending industry, at both large firms and smaller, boutique providers," he explains. "As with many in securities lending it was not a business I had heard of when I was at school, but I have come to realise that it is a unique business that sits at the intersection between all things global capital markets. There is

always something new to learn and new opportunities arising."

What are the most interesting or notable developments in the stock loan industry in terms of the current market position?

"Other than the growth in central clearing that Matthew talked about (where the balances have grown more than tenfold over the last decade), what is most exciting to me right now is that while this has always been an evolving industry, it feels different this time - the pace of change in the industry is quickening and we are in a really transformative period.

"Technology is a key enabler of this transformation. Only a few years ago, we spoke of blockchain as a solution looking for a problem - now we see smart contracts and tokenisation addressing actual business challenges, and we are only scratching the surface.

"The advent of blockchain and DLT and the promise of higher data quality can remove many of the reconciliations that happen today. Participants leveraging OCC's new DLT-based platform will be able to monitor transactions in real time."

If we were having this conversation in five years' time, what areas would you expect to see the greatest development in?

"If we look into our crystal ball we will have our new DLT stock loan system in production and running, and member firms will be monitoring the transactions, which creates a whole new paradigm in terms of availability of data and timeliness"

"From our standpoint, that new programme, the technology and the product itself go hand in hand. That programme is intended to increase and improve transaction workflows and will cost members less, and we are also looking to expand our guarantee in those transactions." ■

More than a token effort

The director of global markets risk and securities lending at the Risk Management Association (RMA) assesses progress on tokenisation of assets and the integration of ESG considerations into securities lending in the US.

Securities lending is an integral part of the financial ecosystem and underpins capital market structure though increased liquidity. The US continues to have the most developed and deepest capital markets in the world and the ability to lend and borrow securities is a primary contributor to that.

While the securities finance industry continues to face regulatory headwinds ranging from bank capital rules and single counterparty credit limits to enhanced transparency initiatives, securities lending will continue to be an important driver in maintaining capital market efficiency and a source of incremental revenue to underlying beneficial owners.

One of the topics generating interest in this space is the potential of tokenisation in the collateral sector. If the field of eligible collateral could be expanded to include tokenised assets, this collateral could be used to secure repo financing, lent out for income in a securities loan, or serve as initial margin on OTC derivatives trades.

Asset tokenisation

Earlier this year, the RMA published a white paper on tokenisation authored by Victor O’Laughlen, managing director and digital business leader at BNY Mellon, in which he suggested that just as a robust collateral infrastructure has developed around securitised instruments, the same potential exists for a thriving tokenised asset collateral sector to emerge.

His view is that by expanding the range of available collateral, tokenisation may facilitate



Fran Garritt, RMA director of global markets risk and securities lending

a lower cost of funding for less-liquid asset classes, since those assets are often funded on an unsecured basis. This will be a key driver of the technology and will generate substantial savings for market participants over time.

O’Laughlen states that wider adoption of tokenised assets will require regulators to determine how to treat such instruments – as securities, commodities, or some other asset type – and update existing rules accordingly. He also suggests that the legal status and enforceability of tokenised assets will develop over time, thereby enhancing investor

confidence, which will make these assets even more liquid and widely acceptable as collateral.

By providing the means for a secondary market to emerge in tokenised assets - which would allow investors to trade and value tokens representing legal ownership of real life assets - blockchain technology and tokenisation could fundamentally change the dynamic of this market.

Market impact

“The lending industry continues to monitor developments in the security tokenisation space,” says Fran Garritt, RMA director of global markets risk and securities lending. “Whether it be impact on market structure (for example, how loans are administered) or the actual lending of tokenised/digital assets, we have working groups across different service providers and beneficial owners to understand the impact on our work stream.”

The RMA has also been keen to explain that securities lending is not inconsistent with ESG, referring to a global survey of beneficial owners published in 2020 in which 95% of participants agreed that ESG investing and securities lending can coexist.

The RMA does acknowledge that it is important for lenders to engage in active communication with their lending agent to understand the impact any lending restrictions or guidelines may have on a lending programme. As a best practice, it recommends lenders review these guidelines periodically for applicability and relevance.

ESG considerations

“With the rise of sustainable investing in recent years, lenders have increasingly looked for ways to incorporate ESG considerations into their securities lending programme,” notes Garritt. “In the US, we most commonly see ESG considerations come into play with proxy voting. More and more lenders are establishing

“ We have working groups across different service providers and beneficial owners to understand the impact [of security tokenisation] on our work stream. ”

formal proxy policies within their securities lending guidelines to help balance active shareholder engagement with generating incremental returns via lending.”

A lender’s proxy policy will often include criteria to assist in the decision on whether to restrict/recall or lend over proxy record date and may include considerations such as materiality of the vote and lending fee/revenue thresholds.

“Collateral guidelines are another area where we see lenders looking to integrate ESG into their securities lending programme,” adds Garritt. “This has not been as common in the US as it has been Europe, likely due to the narrower collateral profile used in the US.”

Enhancing diversity is another key consideration for market participants as the pandemic challenged diversity initiatives and brought to light new issues, such as the difficulty of retaining diverse talent. “Groups such as Women in Securities Finance are integral in helping address these issues,” concludes Garritt. “While the benefits of a diverse workforce have been substantiated, more progress is required to attain a truly diverse industry.” ■

“ With the rise of sustainable investing in recent years, lenders have increasingly looked for ways to incorporate ESG considerations into their securities lending programme. ”



ARGENTINA

Argentina



At the beginning of this year the board of the Banco Central de la República Argentina (BCRA) adopted a number of measures to redesign monetary policy instruments designed to improve conditions for monetary, foreign exchange and financial stability.

The annual interest rate on 28-day liquidity bills (LELIQs) was raised from 38% to 40% and the maximum holding increased to an amount proportional to the stock of private sector's time deposits at each financial institution. The central bank also issued a new 180-day LELIQ at an annual rate of 44%.

As for shorter-term instruments, the BCRA confirmed that 7-day repos would be gradually removed and that overnight repos would continue to be used.

The 28-day LELIQ rate will continue to serve as the reference indicator for monetary policy and will be supplemented by the BCRA's participation in the secondary market of

government securities in order to align the term structure of interest rates and ensure the liquidity of these instruments.

The board also raised the minimum limits of interest rates on time deposits. The new floor annual rate for 30-day individuals' deposits is 39%, whereas the minimum annual rate for the other depositors of the financial system is 37%.

The purpose of these measures is to preserve monetary and foreign exchange stability in a country where economic turmoil persists. As we noted last year, the Argentinian economy has been in turmoil since the South American country requested assistance from the IMF in 2018.

In June 2022 the executive board of the IMF completed the first review of the extended arrangement under the extended fund facility for Argentina, which enabled an immediate disbursement of \$4 billion.

Kristalina Georgieva, managing director, noted that although the Argentine economy was continuing its post-pandemic recovery, it was being affected by shocks associated with the war in Ukraine and broader global uncertainties. Higher global food and energy prices have added to inflationary pressures and challenging fiscal and reserve accumulation goals.

"In the context of recent market volatility, efforts to strengthen and deepen the peso debt market - which is an essential pillar of the 30-month extended fund facility - remain critical, alongside steadfast implementation of fiscal targets," she said. "In addition, ensuring the timely delivery of financial commitments from Argentina's international partners is vital to help boost reserve buffers and support reform efforts." ■



Brazil



The Brazilian securities lending market had almost \$2.2 billion of lendable equities at the end of last year according to IHS Markit.

In terms of value on loan, the 2021 total of over \$1.5 billion represented a more than fivefold increase over the total for 2020 and

was in excess of four times higher than the total recorded in 2019.

Lending revenues of almost \$8.8 million were more than two and a half times higher than in 2020 and comfortably in excess of the total for 2019.

Alberto Ramos, head of Latin American Economic Research at Goldman Sachs says high interest rates mean that tight financial conditions and sluggish economic growth are among the key challenges for Brazil.



BRAZIL

According to the SEC, research from Brazil has shown that improving securities lending transparency led to lower fees, increased liquidity, and increased price efficiency

Alberto Ramos, head of Latin American Economic Research at Goldman Sachs says high interest rates mean that tight financial conditions and sluggish economic growth are among the key challenges for Brazil.

Brazil continues to face the endemic issues of low investment, low productivity, and low growth. Perhaps the most notable aspect of the country is that it continues to underwhelm on the growth front. Excluding 2021 (when growth rebounded from the sharp contraction in 2020) the last time Brazil grew more than 3% was 12 years ago.

According to Ramos, fixing the broken engine of growth to deliver faster, more inclusive growth and at the same time overcome perennial fiscal vulnerabilities which in and of themselves are undermining the growth dynamics is the main macro challenge.

The big challenge for whoever gets to govern the country next is to accelerate investment and growth. Slow social and economic progress for many years and diminished expectations with regards to the future generate social and political

pressure and weaken governability - one of the key issues that comes up repeatedly in discussions with investors.

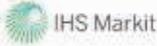
Ramos believes that the central bank will be able to cut rates somewhat in 2023, but that global monetary conditions and the Fed's hiking will limit the policy room to ease. So most likely Brazil will be living for a few years with a restricted monetary policy. Part of that reflects its own inflation reality and a global backdrop of higher core rates.

The SEC proposes to increase the transparency and efficiency of the securities lending market by requiring any person that loans a security on behalf of itself or another person to report the material terms of those securities lending transactions and related information regarding the securities the person has on loan and available to loan to a registered national securities association referenced the market in Brazil.

According to the SEC, research from Brazil has shown that improving securities lending transparency led to lower fees, increased liquidity, and increased price efficiency. ■

Brazil equities 2021 (US\$)

VALUE ON LOAN (US\$)	LENDABLE ASSETS (US\$)	LENDING REVENUE (US\$)
1,544,064,815	2,163,883,985	8,789,419

Source: IHS Markit 



Canada



The Canadian securities lending market had almost \$692 billion of lendable equities at the end of last year according to IHS Markit.

In terms of value on loan, the 2021 total of \$46 billion was a significant increase on the \$35 billion recorded in 2020 and also notably higher than the total for 2019. In contrast, lending revenues only just topped \$300 million, less than half the total recorded in 2019 and down significantly on the \$442 million earned last year.

Data from DataLend covering the first

quarter of 2022 shows lendable assets of \$1.69 trillion and an on-loan value of \$204 billion. It reported revenues of \$115 million with an average fee of 24bps and equities accounting for just under 38% of total revenue.

According to DataLend, the top equity earners were:

- Bank of Montreal
- Enbridge
- TC Energy Corporation
- BCE
- Royal Bank of Canada



CANADA

“ IIROC’s implementation of a cross-asset surveillance system - supported by real time data from our partners at the Montreal Exchange - represents a step change in market surveillance. ”

- Andrew Kriegler, president and CEO IIROC

- iShares S&P/TSX 60 index ETF
- The Lion Electric Company
- Canadian Imperial Bank of Commerce
- Toronto-Dominion Bank
- Fortis

In June 2022 the Investment Industry Regulatory Organization of Canada (IIROC) provided guidance to dealer members on its expectations for implementing a fully-paid securities lending programme.

IIROC initially published this guidance in 2019 with the expectation that it would have rules in place for lending programmes by the end of this year, but based on monitoring of the development of fully-paid securities lending programmes has determined more data is needed to develop appropriate rules.

Currently, five dealers have been granted approval to introduce such programmes. For most of these dealers, their programmes are in the development or early stages where the number of clients enrolled is minimal.

IIROC has said it will continue to monitor how fully-paid securities lending programmes operate and evolve and expects to have rules in place in 2024 before the expiry of the exemptive relief orders provided to dealers in the programme.

At the start of the year the IIROC entered into a memorandum of understanding with the Montreal Exchange regarding cross-market surveillance of the securities and derivatives

markets. Its primary objective is to assist in the development, administration, coordination and fulfilment of the cross-market surveillance mandate given by the Canadian Securities Administrators (CSA) to both self-regulatory organisations.

The two organisations were already sharing information related to oversight reviews, investigations and enforcement activities. The new agreement includes four protocols setting out the roles and responsibilities of each organisation regarding cross-asset trading surveillance, the transmission of relevant data, the sharing of information relating to market surveillance, investigation and enforcement activities, and the coordination of inspections.

“IIROC’s implementation of a cross-asset surveillance system - supported by real time data from our partners at the Montreal Exchange - represents a step change in market surveillance,” said Andrew Kriegler, president and CEO of IIROC.

According to Rob Ferguson, chief capital markets officer at CIBC Mellon, the borrowing community is solving for regulatory initiatives including liquidity coverage ratio to meet short term obligations, and the net stable funding ratio (NSFR) - the liquidity standard requiring banks to hold enough stable funding to cover the duration of their long term assets.

As a result of such requirements there has been an influx of term loans including



CANADA

IIROC’s implementation of a cross-asset surveillance system - supported by real time data from our partners at the Montreal Exchange - represents a step change in market surveillance.

- Andrew Kriegler, president and CEO IIROC

Government of Canada bonds, US Treasuries, and provincial debt. There has also been increased demand for transformation trades as borrowers look to upgrade lesser forms of collateral such as equities for HQLA.

Ferguson referred to an uptick in term loans including transformation trades in the programme as Canada’s Office of the Superintendent of Financial Institutions (OSFI) required Canadian chartered banks to start reporting the NSFR at the end of 2020.

Large exposure/counterparty credit limits has resulted in agent lenders having to further diversify their borrower base along with considering other routes to market such as utilizing a CCP. It has also highlighted the cost of indemnification for agent lenders.

When asked to outline the main drivers of liquidity in securities lending and financing markets during 2022, Ferguson stated that market stakeholders would be watching central bank actions carefully around rates, quantitative easing and more.

Collateral flexibility will remain a key focus

and borrowers and lenders are expected to continue to become more sophisticated, taking interest in data and reporting. Canada is next to the world’s largest, most liquid market and as a result there is a premium on innovation, technology and resiliency.

Market participants continue to take confidence from Canada’s stable financial sector and the country remains an investment destination of choice for many global financial institutions. Canada maintains one of the few remaining triple-A ratings for sovereign debt and continues to attract global investors with its robust market infrastructure, efficient settlement mechanisms and effective regulatory environment.

In January, the Canadian Capital Markets Association (CCMA) announced plans to shorten Canada’s standard securities settlement cycle - the simultaneous exchange of securities for certain payment - from two days after trade date (T+2) to one day after trade date (T+1). The target transition timing for the change is within the first half of 2024.

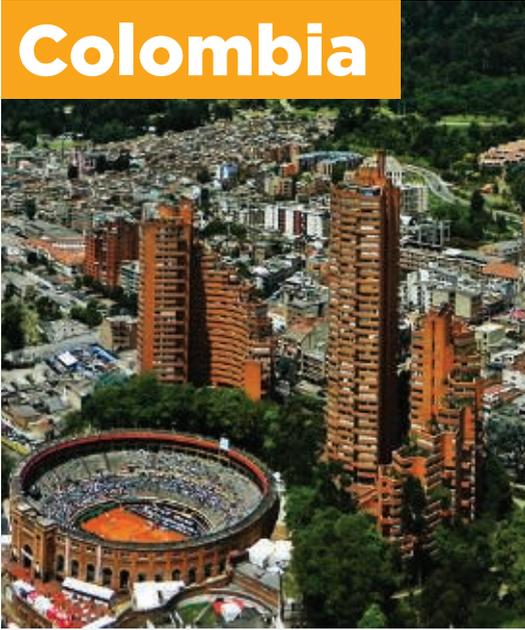
Canada equities 2021 (US\$)		
VALUE ON LOAN (US\$)	LENDABLE ASSETS (US\$)	LENDING REVENUE (US\$)
46,240,029,695	691,715,280,735	300,820,277

Source: IHS Markit



COLOMBIA

Colombia



A webinar on the potential of the Latin American market hosted earlier this year by BBH heard that Colombia had approximately \$80 billion in assets under management invested in four pension funds, which are known as administradoras de fondos de pensiones or AFPs and are increasingly open to foreign fund managers.

“Generally speaking, in order for a fund to be attractive to a pension fund it needs to be fairly large in size, in an attractive asset class and have a competitive performance record against benchmarks and peers,” said Diana Roa, director at HMC Capital.

She added that in Colombia there is a minimum \$1 billion AUM for a fund to be considered by an AFP. Colombia (and Peru) still accept full fee funds, although the former

is moving toward requiring fee discounts as well.

In November 2021 the stock exchanges of Colombia, Chile and Peru announced that they had approved a merger plan for a regional holding company - based in Chile - that would create the second largest bourse in Latin America.

The Colombia stock exchange (Bolsa de Valores de Colombia) has control of 40% of the new exchange, which was described as a great achievement by Juan Pablo Cordoba, head of Colombia’s stock exchange.

“This integration will mean moving borders and having a grander vision for the development of Colombia’s and the region’s capital markets,” he said.

The average valuation of the Colombia stock exchange is very close to that of its Chilean counterpart, whereas the Peruvian exchange has a significantly lower average valuation, which explains why the large exchanges were each given a 40% stake in the new entity.

The new exchange is expected to increase the number of debt issuers, attract international participation, increase regional investment in pension funds, and raise the volume of derivatives.

“In this way, we can attain a greater development of the regional market through the standardisation of business models and the creation of technological and operational synergies,” said a joint statement issued by the three exchanges.

In July, the Colombia stock exchange reported that the median economic growth forecast for 2022 was 6.4%. The annual inflation rate reached 9.7% in June, slightly above analysts’ forecasts. ■



Mexico



The Mexican securities lending market had almost \$33 billion of lendable equities at the end of last year according to IHS Markit.

In terms of value on loan, the 2021 total of \$673 million was a welcome increase on the \$568 million recorded in 2020. However, it was still well down on the \$768 million recorded in 2019. Lending revenues came to just over \$2.5 million, representing a slight uptick from the 2020 total but still considerably lower than the 2019 figure.

Mexico's main stock exchange, Bolsa Mexicana de Valores (BMV) recorded an increase of MXN 32 million in revenues during the second quarter of 2022 – from MXN 965 million to MXN 997 million - compared to the same period last year due to higher transactional revenues (equity, derivatives, and OTC) and new information services clients.

Cash equities revenue (which mainly comprises local and global market activities) was 6% higher than the second quarter of 2021 and trading revenues also increased by 6% because of higher value traded.

The average daily trading value for the second quarter of 2022 was MXN 19.3 million, 10% higher than the second quarter of 2021. The local market increased 21%, while the global market showed a similar figure to that of last year. During the second quarter, cash equity clearing increased by 6%.

Banco de Mexico's quarterly report covering the same period notes that economic activity showed a moderate reactivation, while the environment of uncertainty has generated some episodes of volatility in domestic financial markets.

Annual headline inflation remained significantly above the 3% target, while core inflation continued to increase. Banco de México says it will continue to focus on seeking an orderly and sustained convergence of inflation toward its target within the time frame in which monetary policy operates, being ready to take more forceful measures if conditions require.

Economic activity grew after declining in the third quarter of 2021 and showing weakness in the fourth quarter. This recovery mainly reflected the dynamism of manufacturing and a moderate improvement in services.

BBH describes Mexico as one of the two big fish waiting to be caught in Latin America from an asset management perspective.

Optimism grew in 2019 when the Mexican Chamber of Deputies published an amendment to the Pension Savings System Law that aims to enable pension



MEXICO

fund managers or AFOREs to expand their investment options to increase their returns and for foreign managers to raise assets.

While the latter has been a slow burn, figures show that several dozen global asset managers are now registered in Mexico with more than 100 funds available for sale and these numbers continue to grow.

With the maximum foreign manager exposure set at 20% by the regulator, which is still on the lower end of scale, BBH reckons there is plenty of upside for managers seeking opportunities to invest the assets of Mexico's AFOREs.

ESG investing has been a focus for institutional clients and the country's regulation is mandating that these pension funds have to incorporate sustainable criteria in their methodologies and prioritise ESG investments in their portfolios this year.

Under the regulation, they also need to publicly disclose whether they integrate ESG factors in their investment process and how they do it. Those fund managers with strong track records in their ESG products - but perhaps more importantly, in how they provide data points to help investors such as these pension funds comply with their ESG requirements - will clearly have better opportunities to raise assets.

Earlier this year, BBH hosted a webinar of

cross-border fund experts to discuss the potential of the Latin American market and provide guidance on the best ways to market and distribute to local investors.

Diana Roa, director at HMC Capital described pension funds in Mexico, with almost US\$250 billion in assets, as a 'very big market' for foreign asset managers in the near future.

"Chile has had more time to experience the investment process and is more knowledgeable," she said. "When you look at their portfolio composition, they have roughly 50% equally in active and passive management, while Colombia and Mexico are still migrating from passive ETFs management to active management."

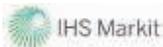
Roa said that Mexico's regulator recently gave approval to pension funds investing offshore directly, rather than through mandates. The regulator currently sets a limit of 20% on allocations to foreign funds, but the actual investment percentage is closer to 12%.

Killian Lonergan, head of distribution intelligence at BBH said he believed that only four or five of the country's 10 pension funds are actively looking at foreign funds at the moment. He said that recent data indicates there were 130 foreign funds registered in Mexico, involving 30 managers, who have to meet a \$50 billion AUM minimum in Mexico in order to be considered. ■

Mexico equities 2021 (US\$)

VALUE ON LOAN (US\$)	LENDABLE ASSETS (US\$)	LENDING REVENUE (US\$)
673,220,319	32,977,434,589	2,511,133

Source: IHS Markit





United States



The US securities lending market had more than \$16.1 trillion of lendable equities at the end of last year according to IHS Markit, accounting for a substantial proportion of the almost \$16.9 trillion in total lendable assets across North America.

In terms of value on loan, the 2021 total of \$576 billion was a welcome increase on the \$428 billion recorded in 2020 – which was down from \$458 billion the previous year.

Lending revenues of \$3.5 billion showed only a modest increase on the total for 2020, but were more than \$600 million higher than in 2019.

According to DataLend, the Americas recorded the largest increase in lender-to-broker revenue of any region last year (+22.3%).

The top five revenue-generating securities in the global securities lending markets in 2021 were Robinhood Markets (HOOD), iShares iBoxx \$ High Yield Corporate Bond ETF (HYG), Blink Charging (BLNK), VMware (VMW) and Visa (V), which together generated \$413 million in lending revenue.

In May 2022, Robinhood introduced stock lending, which it described as its ‘democratised approach’ to fully paid securities lending.

“Our version of stock lending empowers customers to put their investments to work

while keeping it simple,” said Steve Quirk, chief brokerage officer. “Robinhood does the work of finding borrowers and managing transactions while customers can add a potential source of passive recurring income to their portfolio.”

By using the service, customers give Robinhood permission to lend out any fully paid stocks in their portfolio. Once shares are loaned out, customers can track earnings, see their positions, and enable or disable stock lending through an in-app dashboard.

The meme stock craze – combined with the popularity of special purpose acquisition companies – goes a long way to explaining last year’s revenue growth. The number of special purpose acquisition companies that went through initial public offerings (IPOs) in 2021 was more than twice the figure for 2020.

There was also increased demand in exchange-traded funds (ETFs) as hedge funds looked to gain market exposure through more liquid investments resulting in new ETF short positions.

The emergence of ETFs towards the latter part of last year was primarily driven in the US, where the iShares iBoxx \$ High Yield Corporate Bond ETF was the second highest revenue-generating stock in the whole securities lending market during 2021.

Analysis of US equity specials trading published by S&P Global Market Intelligence in March 2022 noted that the US equity finance market has evolved over the last few years – impacting both hard to borrow shares and easier to borrow shares or general collateral. Changes in risk tolerance, regulation and asset flows have fundamentally changed the nature of supply and demand.

Prior to the global financial crisis in 2008 there



UNITED STATES

were relatively few US equity specials. That was particularly true for deep specials, defined as equities with a fee greater than 20% annualised - in 2007 the average daily number of US equity deep specials was 15 and the \$33 million in revenue generated contributed just 2% to total US equity revenue.

In 2008 the count increased to 40 equities and the contribution more than tripled to 7%.

In 2007, US equities with average fees greater than 500 bps contributed 27% of total revenue, while shares with greater than 2,000bps contributed only 2% of total revenue. From 2010 to 2020 shares with fees in excess of 500bps contributed 45% of annual revenue on average, while shares with fees of more than 2,000 bps contributed 22% of annual revenue.

In 2009 the Citi recapitalisation trade was an outlier, generating more revenue than the rest of the top 20 US equities combined. Despite the outlier status, the Citi trade did illuminate the potential for substantial engagement around lending into a corporate action related trade for lenders and borrowers.

In 2011 and 2012, the modern age of specials started to emerge, led by Sears Holdings Corp, which was the top US equity earner in both years. While the revenue contribution percentage from > 2,000bps specials dropped from 2013 to 2018, the nominal revenue and contribution percentage remained substantially above the pre-GFC level.

The next stage in the evolution of specials trading began with the Beyond Meat IPO in 2019. Subsequent IPO lockup expiries and other corporate actions such as warrant redemptions and exchange offers have generated similarly eye-catching fees, with 2020 yielding \$1.2 billion in revenue from > 2,000bps shares - 35% of



“ Securities lending and borrowing is an important part of our market structure. Currently, though, the securities lending market is opaque. ”

- Gary Gensler, chair SEC

total revenues.

The implications of Basel III and Dodd-Frank were that broker-dealers were best served by maximising the internal usage of assets. At the same time, hedge fund AUM grew substantially in the three years following the GFC, increasing the assets being financed by prime brokers on the long side.

The average fee for shares which were special increased from 2014 onward. The increased focus on extracting maximum revenue from hard to borrow shares is correlated with the reduced borrow demand for general collateral.



UNITED STATES

The increasing fees for hard to borrow shares reflects the relatively thin proportion of borrow demand for those shares which can be internalised by broker-dealers. Effectively the market is becoming bifurcated, which means that hard to borrow shares where there is friction in the borrow can become extremely volatile, which can in turn impact the cash market for trading shares when one side of the trade is virtually unable to act.

From a regulatory perspective, in November 2021 the SEC voted unanimously in support of a proposed rule designed to strengthen the transparency and efficiency of the securities lending market.

SEC chair, Gary Gensler, acknowledged that securities lending and borrowing was an important part of the market structure and could help investment funds, endowments, and pension funds generate additional revenue. He also noted that the borrowing process can help broker-dealers and investors participate in market-making, short selling, and other activities.

However, he also described the securities lending market as opaque in that although private data vendors collect and sell some lending data, this information is incomplete since not all market participants choose to participate.

Gensler noted that market participants have

had to pay to subscribe to multiple feeds to access even the limited data available and that these factors result in information asymmetries between borrowers and lenders, creating inefficiencies in the market.

After the 2008 global financial crisis, Congress instructed the SEC to strengthen the transparency of the securities lending market.

Under the proposed rule, data about securities lending transactions would be reported to a registered national securities association within 15 minutes. Further, at the end of each business day lenders would be required to report the number of shares of each security they have lent out, as well as the number of shares available to borrow.

However, the Risk Management Association has disputed the view that securities lending lacks transparency, observing that a number of vendors offer daily securities lending market information, representing over \$2 trillion in open loans.

Available data points include loan volumes, utilisation rates, and fees paid, which provide general market colour as well as benchmarking a lending programme's performance versus the broader industry. Benchmarking results can also be filtered to compare against peers based on domicile, fund type, collateral type, and other criteria according to the RMA. ■

United States equities 2021 (US\$)

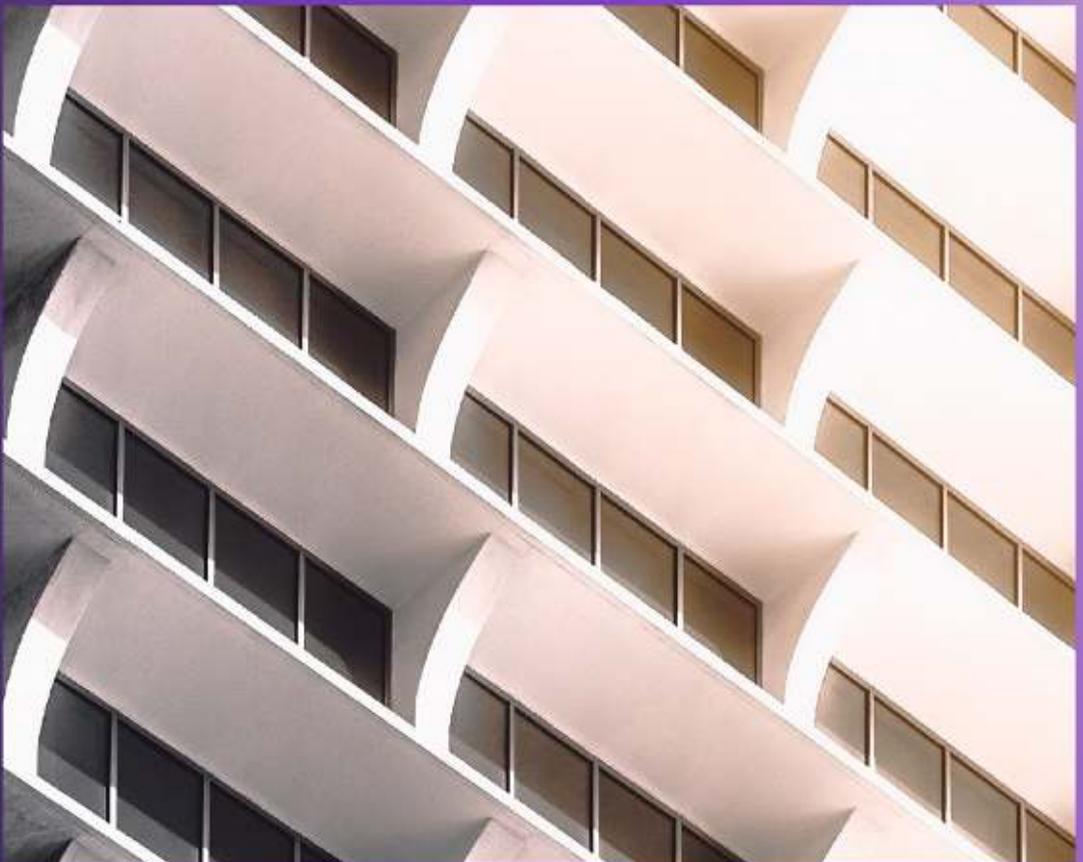
VALUE ON LOAN (US\$)	LENDABLE ASSETS (US\$)	LENDING REVENUE (US\$)
576,311,097,449	16,145,360,236,382	3,537,657,310

Source: IHS Markit



37th Annual Securities Finance & Collateral Management Conference

The Ritz-Carlton Key Biscayne, Miami | October 10-13, 2022



GLOBAL SECURITIES FINANCING

More than just securities financing,
together we can create the right solution



*For the 3rd year in a row
*Group 2 Borrower - Global Market Lenders and Borrowers were split into 2 groups based on the volume traded

Natixis Corporate and Investment Banking offers high quality solutions thanks to its in-depth knowledge of the Securities Financing market.

Collaboration || Financing || Solutions

Contact: Romuald Orange, GSF - Global Head of Client Strategy
Tel: +33 1 58 55 11 09 - romuald.orange@natixis.com

www.cib.natixis.com



 GROUPE BPCE

 **NATIXIS**
CORPORATE AND
INVESTMENT BANKING