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Securities Finance Americas Guide 2021

Summer 2021
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THE GPFA IS BUILDING MOMENTUM IN THE US AND ABROAD

+ COUNTRY PROFILES

The latest securities finance developments in the region's key markets

The progression of ESG and the different routes to market within America's securities lending

Don D'Eramo, managing director and global head of securities finance and **Kyle Kolasingh,** associate director of securities finance at RBC Investor & Treasury Services (RBC I&TS) discuss recent trends in the Americas securities lending market such as ESG, specifically governance, and the increased focus of accessibility found within multiple routes to market.

Growing interest in ESG among beneficial owners and borrowers is a key trend across the global securities finance industry. In North America, the Securities Industry and Financial Markets Association (SIFMA) has noted that environmental, social and governance considerations are increasingly shaping the way investors choose to engage with companies and thus how companies do business.

"If you think of how one of the main aspects of ESG – governance – has been managed within the lending industry over more than a decade, it has been to recall or reallocate the security and free the loan position," explains Kyle Kolasingh. The ability to facilitate proxy voting and a well-functioning securities lending programme has not changed. We are however seeing more of this activity and having wider discussions on integrating such mandates into lending programmes as clients are looking into their overall governance strategy as part of their investment guidelines," he continues. "In the past, a higher number of clients would have selectively chosen which securities to vote, whereas now clients are considering what the next step looks like and how to integrate a wide-ranging proxy mandate with their agent lender to monitor securities and integrate that into their overall ESG strategy."

RBC I&TS has had this mechanism in place for some time and continues to monitor securities in its clients' lending programmes for those who want to proactively recall assets ahead of proxy dates. It also has regular discussions with clients to make sure the lending programme is compatible with the client's overall investment strategy. In this context, governance is not the only significant factor since there are other considerations, such as collateral. "We are also having more in-depth discussions on how

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short-term views fit in with ESG considerations and the association between securities lending and short selling,” says Don D’Eramo. “These conversations need to continue to evolve if liquidity is not to be hindered.”

The extent to which ESG considerations are integrated into the management of securities lending depends on how each beneficial owner has applied them from their investment strategy. From an RBC I&TS perspective it is about ensuring that beneficial owners achieve portfolio optimisation from their securities lending programme and maintain ESG compliance. “This business is complex even without ESG overlays. However, the strategy is always dictated by the underlying client, whether that is divesting from certain sectors or restricting certain sectors of collateral,” says D’Eramo. “Securities lending has always appeared to be a pretty straightforward industry on the surface, but the complexity comes from having to manage varying client goals,” he adds.

It has been suggested that the events of 2020 have underlined the importance of allowing clients to transact on a cash as well as a non-cash collateral basis. D’Eramo acknowledges that there was a flight to quality in the early stages of the pandemic, but suggests the collateral issues need to be looked at from a regional perspective. “In Canada, for example, the balance between cash and non-cash collateral has not changed in favour of the former over the last 12 months,” he says. “The US is still a predominantly cash market but reinvestment opportunities have presented some challenges given the situation with rates. There are some regulatory prohibitions around non-cash growth in the US which if removed would probably lead to increased use of non-cash collateral.” D’Eramo notes that Europe falls somewhere in between with a slight bias towards non-cash collateral.

“Overall we have seen increased demand for non-cash collateral from our counterparties in terms of ETFs, equities and term,” he adds. “Term went away somewhat as central banks introduced a lot of liquidity into the system but has started to return, albeit slowly.”

Another topic that has generated debate is the use of third-party agency lending by institutions and asset managers. “If you look at an agent lender such as RBC I&TS that has product capabilities across multiple client types and sectors (e.g., UCITS, pensions, sovereign/government institutions, insurance and asset managers), you have a very robust offering and the ability to provide a route to market that conforms to what clients want,” explains D’Eramo. “There are a few market participants who specialise in this type of lending (i.e., third party) in a concentrated way, for example, focusing on asset class transactions that are very narrow in scope,” he adds. “This may present opportunities in certain segments of the market.”

The decision to use a third-party agency offering often comes down to how the underlying beneficial owner sees their goals. For example, there may be large sovereign wealth funds with multiple providers who are not always their custodian. These funds may use multiple providers as an opportunity to diversify or even compare performance with the aim to achieve a best-in-market outcome. “The asset servicing discussion will span

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multiple disciplines, which makes this space more challenging,” says D’Eramo. “There is room for third-party lending, but it is not the most significant part of the market.”

Kolasingh agrees that this type of lending tends to take place in concentrated portfolios where the operational nuances are different from custodial lending. “Sophisticated beneficial owners of scale - typically government institutions - continue to assess what is best in class for these highly concentrated portfolios and third-party lending is gaining some traction in this space,” he says. “Agent lenders who can offer multiple routes to market by facilitating both the custodial and non-custodial lending are attractive to such beneficial owners as it allows for multi-model securities lending programmes to exist, allowing diversified optimisation of one’s lending portfolio.” adds Kolasingh.

Over recent years, the securities finance industry has seen the introduction of various initiatives designed to make the market more accessible, including peer-to-peer lending. So what are the implications of this ‘democratisation’ of the market for agent lenders?

“The retail investor segment has been growing, but not as fast as might have been expected,” says Kolasingh. “Expansion into different supply pools has been ongoing for a while and we have offerings where we show opportunities to clients that are not in lending to be able to participate in this market where we feel value is available.” There are dealers in the US that have margin securities for other clients and make these available for loan. This business continues to develop and has co-existed with the broader institutional lending paradigms. “I see this continuing but I am not sure it is revealing anything about the retail space that was previously unknown,” adds Kolasingh. The governing body for broker dealers in Canada has looked at creating guidelines for retail client assets to ensure there is an understanding of the risks and the market.

“This business is targeting intrinsic value securities, so if conviction continues to return to the market and we see more directional demand, supply will be borne out of that,” says D’Eramo. “However, what is equally important is not so much the ability of this business to co-exist with agency lending but rather the fact that agency lending is regulated, highly transparent for clients and capable of being bespoke based on client requirements. When you move into the retail space, I am not sure if all these characteristics are present yet and regulators will potentially want to understand how these issues are addressed as the market for lending retail equities matures,” he adds.

D’Eramo refers to peer-to-peer groups engaging in discussions around market practices as a healthy development for the market. “Over the past 18 months, we have created solutions for clients who want to gain leverage or run certain types of investment strategies where securities lending can be part of the solution. We expect that this peer space will continue to grow,” he concludes. ■