**Kyle Kolasingh**
Director of securities finance
RBC Investor & Treasury Services

# Progress in the face of uncertainty

*Despite a particularly volatile environment, securities lending continued to thrive in 2022. Kyle Kolasingh, director of securities finance at RBC Investor & Treasury Services, shares his perspective on the past year and what lies ahead for 2023*

It has been a strong year for securities lending, with annual industry revenues up by approximately 15 per cent globally, based on information provided by S&P Global. While volatility inherently brings challenges, it ultimately proved beneficial for securities lending, creating openings for a diverse range of financing transactions and lending opportunities.

For the third year in a row, we saw a turbulent first quarter, which was marred by the Russia-Ukraine conflict. An important point to take from this period of 2022 is the resilience demonstrated by securities lending. The industry moved quickly to align with a range of regulatory requirements and sanctions that affected both assets on loan and those used as collateral. This speaks to the strength of the lending market and bodes well for the future, demonstrating the sector's ability to adapt and thrive in challenging times.

As central banks started to taper their quantitative easing programmes, market participants returned to the financing market to source liquidity. This made for a healthy fixed income market, giving rise to an increased appetite for Canadian government and provincial bonds on both an open and term basis. Where flexibility in collateral was permitted and duration could be taken, beneficial owners holding such assets continued to capture significant premiums on overnight fees. Corporate bonds have also been high performers as pressure on the credit environment had a positive impact on borrower demand in 2022. We expect this demand for fixed income assets to continue in the new year.

On the equities side, exchange-traded products (ETPs) remained a popular borrow, providing a convenient way to hedge or gain sector exposure. This is a trend that we expect to continue into 2023 — particularly for high-yield bond ETPs, given ongoing market volatility and economic uncertainty. Entering the new year, continued geopolitical uncertainty across the European region, coupled with an evolving inflationary and recessionary environment throughout much of the developed world, will likely contribute to further market volatility. However, as the past has shown, such volatility brings opportunity for securities lending as financing demand adapts.

### Unlocking new supply

We are seeing increased demand for enhanced reporting and data access to support more informed decision making on the part of new and existing beneficial owners. An example is corporate bonds, where current market conditions may give rise to liquidity concerns. In a rising rate environment with volatility and credit pressure, access to the right data provides beneficial owners with clearer insight into the risk and reward trade-off associated with securities lending. Close communication with agent lenders is also vitally important. We continue to foster strong relationships with our beneficial owners to ensure that their understanding of the financing market aligns with their goals and risk parameters.

Another growing area relates to the retail side of the market. The meme stock craze of early 2021 demonstrated the scale and importance of retail investors' contribution to the financing market. This segment generated significant lending returns in 2021 and 2022. Known as "fully-paid lending" in the US, the retail segment has come to market in Canada. In particular, Canadian wealth managers are increasingly seeking opportunities to add incremental value and boost returns for their retail investor base through securities lending — a trend that is likely to continue in 2023.

### T+1 and transparency

Although T+1 will not be implemented in Canada and the US until at least 2024, much of the heavy lifting to prepare for a shortened settlement timeframe will take place in 2023 through to 2024. While changes to securities lending activities are still under discussion, T+1 will ultimately reduce the time to recall a security by one day. Not unlike the move to T+2, the securities lending industry supports efforts to improve market efficiency. Other market changes planned for 2024 —

including Canadian Depository for Securities (CDS) modernisation and a potential “fails regime” on Bank of Canada government securities — point to a busy time ahead here in Canada.

The industry will be watching closely as the US Securities and Exchange Commission (SEC) wraps up its Rule 10c-1 draft legislation, which aims to provide further transparency in the securities lending market. It remains too early to say how these proposed changes will affect Canadian beneficial owners, or the Canadian market of lendable securities. However, it is likely that the capabilities built and designed by industry participants for the Securities Financing Transactions Regulation (SFTR) in the EU and UK will be leveraged and, perhaps, even enhanced.

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Another area that we expect to receive greater attention in 2023 is digital assets and digitised technology. T+1 may well be the beginning of a discussion leading to T+0, or same-day settlement, which could benefit from some form of distributed ledger technology. The International Securities Lending Association (ISLA) recently published a report that highlights considerations for digital assets, and this area will undoubtedly be a fascinating evolution for securities finance.

**ESG isn’t going away**

ESG is a topic that I discuss with clients on a daily basis. We have always recognised that securities lending promotes sustainability of the wider capital market system by providing access to liquidity and balanced views for price discovery. However, as beneficial owners have been increasingly utilising proxy voting to fulfil ESG policies in recent years, there has been much discussion of its compatibility with securities lending.

Now this discussion is evolving. Increasingly, asset managers are employing securities lending as part of their overall ESG framework. For example, they may opt for a stronger position than divestiture from a sector — taking directional positions rather than long investments. They may also regard participation in securities lending as a contributing factor to overall sustainability of the capital markets ecosystem. This has effectively taken the discussion beyond compatibility concerns to the deployment of holistic, ESG-driven investment strategies that incorporate securities lending.

There is further discussion around the potential application of ESG principles beyond investment portfolios to collateral management. It is important to note that the creation of collateral exclusions based on ESG considerations has the potential to reduce the benefits of diversification and lead to increased concentration risk, which could ultimately diminish the risk-mitigating function of a collateral portfolio.

In November 2021, the Global Alliance of Securities Lending Associations (GASLA) published a best-practices guide on proxy voting and has been working towards a refreshed version of the Global Framework for ESG and Securities Lending (GFESL), which will encompass collateral management and related topics.

When all is said and done, ESG will continue to evolve away from the familiar proxy voting dialogue to a more holistic and positive force, which will inevitably be ingrained in almost everything that we do.

**Diversity makes us stronger**

Looking forward, I am hoping to spend more time amplifying the diversity, equity and inclusion discussion within the securities lending industry — this is particularly important to me on a personal level based on my own background.

This year, we saw Women in Securities Finance — which recently celebrated its fifth anniversary — not only continue to champion gender diversity, but also broaden the conversation to include more universal equity and inclusion. Ultimately, greater diversity will strengthen the securities lending industry through wide-ranging perspectives and place us in a better position to face a constantly-changing market in the years ahead.