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A positive outlook

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Donato D'Eramo, head of securities finance at RBC Investor & Treasury Services (RBC I&TS), speaks to SFT about his team's projections for Canada's securities lending market, its commitment to data innovation and CASLA's regulatory focus for the year ahead

How do you assess the current outlook for Canada's securities lending markets?

At RBC I&TS, we expect the positive outlook to continue for securities lending markets overall. This will manifest itself through two main themes: continued new market expansion and developing demand for new routes to market. Both are linked to the current macroeconomic environment and refinements that clients are making to their lending and collateralisation strategies in this context.

New markets will continue to offer incremental revenue opportunities for beneficial owners. We are focused on markets that will deliver higher intrinsic value, as opposed to general collateral (GC) demand. Over the past year, we have entered new markets for clients in Taiwan, Poland, Israel and Czech Republic.

Developing demand drivers may be the more interesting theme for clients and we are noticing a number of ongoing developments that impact client behaviour. As central banks shift to quantitative tightening and a rising interest rate environment, this will translate into stronger demand for the fixed income segment, particularly for high-quality liquid assets (HQLA) and term structures for clients that have the risk appetite and regulatory capabilities to monetise this demand. Alongside term demand, we see growing demand for 'on the run' government issues, which will translate into increased 'specials' activity and returns for clients.

We also see positive sentiment in the equity and corporate bond segments, particularly around opportunities to capture intrinsic value. The corporate bond segment has been a strong performer, along with directional demand in the equity segment. Much of this demand is the result of fundamentals, improving M&A activity overall, and growth in optionality events.

What are the strategic priorities for RBC I&TS agency lending for H2 2022 and into 2023?

One of RBC I&TS' strategic priorities is to ensure that our clients have access to the data and information necessary to evaluate and capture the emerging demand opportunities that I have highlighted. We have a keen focus on providing digital solutions for our clients. One example is the recent roll out of securities lending dashboard analytics for clients. Beneficial owners are increasingly looking for data insights to support their lending strategies, whether this is to support revenue analysis, regulatory oversight or ongoing developments of their ESG direction of travel.

In parallel with this data strategy, we are focused on delivering exemplary standards of client service. This involves high-touch connectivity with clients, enabling the ongoing transfer of market and technical information as opportunities arise. As mentioned, the demand drivers presented by corporate bond and corporate action optionality are an important determinant of programme performance and serve as a differentiator for clients, becoming increasingly important as GC revenue becomes a smaller contributor to overall returns for clients.

These advances in data management and client service are creating greater transparency for our clients, enabling them to make quicker decisions and to extract optimal value from their lending opportunities. This data transparency is also important in supporting clients' appetite for customisation, driven by regulation and other factors.

On balance, we continue to see growth in supply via various routes to market — ranging from specialist to generalist approaches from the client base — and our agency lending product offers the scope to support a wide range of client mandates. As noted, we continue to see growth in mandates focused on intrinsic value for clients that may not want exposure to GC markets. Some client mandates are highly sensitive to meeting liquidity parameters, particularly in the context of recent regulatory changes (for example, the Central Securities Depositories Regulation in the European Union), which are having significant impact on settlement liquidity. In other situations, we are providing guidance to clients on the potential impact of the proposed SEC 10c-1 regulation (relating to the Securities and Exchange Commission's proposed trade reporting regime for securities lending transactions) and the potential transition to T+1 settlement as the proposed next-day settlement regime for US and Canadian markets.

To enable clients to optimise opportunities focused on intrinsic value, we have developed a 'try before you buy' option. In parallel with our data transparency strategy and the provision of high-touch connectivity, our offering provides prospective clients with the ability to engage in one-off securities lending transactional opportunities. This facility has been successful in enabling clients to take ownership of the decision on a transaction-by-transaction basis, without engaging in a full discretionary mandate.

With respect to collateral preferences, we continue to see a growing appetite for non-cash collateral, which currently represents over 60 per cent of the global agency lending market. In this regard, the US remains a significant outlier as a predominantly USD cash collateral market. Given the importance of non-cash collateral, against a background of quantitative tightening and rising interest rates, the appetite for collateral transformation continues to be important for clients with a risk tolerance that allows them to widen their collateral schedules. This trend is particularly important in Canada, which is predominantly non-cash collateral rather than a USD cash collateral market.

More generally, RBC I&TS observes strong lending growth activity in a number of other areas of the securities lending market in Canada. There has been tangible expansion in exchange-traded funds (ETF) lending, driven by a mix of outright directional, spread strategies and hedging strategies. The cannabis sector also continues to attract borrower demand as the legalisation debate progresses in the US.

As a CASLA director, what have been the priorities within the association in managing regulatory change, in promoting digitisation and standardisation initiatives, and in supporting sustainable lending?

At the Canadian Securities Lending Association (CASLA), the Tax & Regulatory committee recently submitted a letter of support to the US SEC backing the submissions of the Risk Management Association (RMA) and the Securities Industry and Financial Markets Association (SIFMA) regarding proposed Rule 10c-1. This was viewed with high importance, given the potentially wide-ranging scope of Rule 10c-1 for CASLA members.

As and when further details of the SEC's proposal are released, CASLA will continue to work with members and relevant industry associations given the significance of this regulatory change in the region. The change to T+1 settlement is of comparable importance. CASLA representatives sit on both the Canadian Capital Markets Association's (CCMA's) Operations Working Group and Communications & Education Working Group as the industry works towards a 2024 implementation of T+1, the same as in the US. Given the rising importance of ESG in securities lending, the Global Alliance of Securities Lending Associations (GASLA) was established in 2021 to address common issues that we face around ESG, including governance models, collateral management and transparency improvements. CASLA was one of the founding members of this global association.

GASLA has already proven to be a productive forum, publishing a best practices guide on proxy voting, for example, and now working to advance the Global Framework for ESG and Securities Lending (GFESL). Given the importance of ESG, GASLA's work to bring standardised models to the industry is essential in supporting sustainable lending practices.