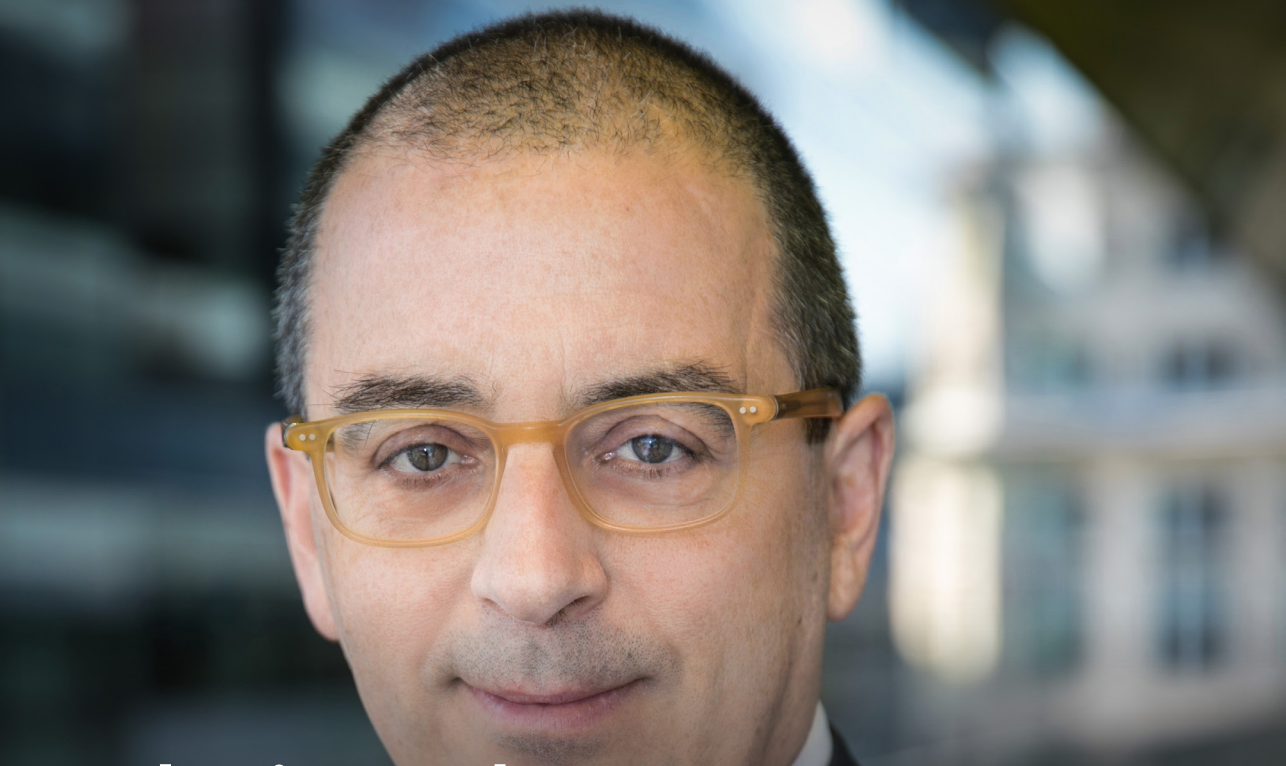
securities lending times

ASIA2018



Adapting to change

With a lot of change in the Asia securities lending market, Don D'Eramo, Global Head of Securities Lending at RBC Investor & Treasury Services, explores the region's changing revenue profile and ongoing technological changes

The Asia securities lending market has been in a period of constant change recently. We need only look at the revenue profile and technological advancements in the industry to gain insights into some of the primary drivers.

Changing revenue profile

In 2015, Hong Kong was the standout securities lending market in Asia. The territory accounted for approximately 40 percent of revenues in the region, mainly derived from lending high intrinsic value securities. At the time, the lending of such securities represented over 80 percent of the revenues in Asia, according to IHS Markit data in 2015.

As markets in the region evolved, various corporate events have affected demand in the Hong Kong market, ultimately impacting fundamentals. The knock-on effect of this changing market dynamic produced an environment of lower directional demand, resulting in downward securities lending revenue trends. In addition, several domestic lenders re-entered the market. This has increased the supply of lendable assets, contributing to higher overall liquidity and a change to the revenue mix across Asia.

Fast forward to 2018 and, while Hong Kong continues to grow and remains integral to the region, Japan has emerged as the largest securities lending market in Asia. According to IHS Markit, Japanese securities lending revenues jumped 40 percent year-over-year in 2017, with average fees generated by Japanese equities surging 50 percent to approximately 120 basis points.

This change has been led by high demand for Japanese small cap and technology securities. As some of these

securities are not widely held in domestic lending pools, borrowers have been prepared to pay a premium, leading to an upward trend in securities lending revenues within the Japanese market. Furthermore, Japanese companies have been active in the capital-raising space, leading to increased demand for such names and generating a healthy interest in borrowing. Japan was previously characterised as a general collateral to warm market, and the turnaround has been driven by an influx of high intrinsic value securities.

On the fixed income side, negative interest rates in Japan have increased demand for federal government bonds and treasuries or other government bonds, further adding to the traction gained in the securities lending market. Generally, activity in Asia has also been influenced by Basel III requirements, resulting in an increase in capital-focused trades such as collateral upgrades and term loans, optimising such high-quality liquid assets (HQLA).

Overall, securities lending activity in Japan has balanced the softening of other traditional Asian securities lending markets such as Singapore and South Korea, where demand has been curtailed by fewer high intrinsic value securities in the market coupled with regulatory constraints.

Capturing value through technology

Alongside the continually shifting dynamics across different borders in Asia's securities lending markets, ongoing technological change has also been at the forefront in the region.

New processes and capabilities are enabling the automation of various parts of the securities lending lifecycle, driving higher hit rates where loans are now booked by straight-through processing (STP). There have been numerous benefits derived from the increasing use of STP including a reduction in operational errors and expedited reaction times. The days of booking general collateral tickets are generally associated with a bygone era.

Additionally, beneficial owners have traditionally been reluctant to lend in buy-in markets due to the potential penalties handed out by the exchanges. However, automation across the industry has provided the risk/return comfort needed to attract additional supply to the market. Ultimately, continued enhancements made to counterparty connectivity have enabled more efficient management of lendable assets, resulting in further optimisation of beneficial owner revenues. In general, technology has produced higher utilisation levels for beneficial owners by the mere fact that agent lenders can communicate with brokers in a broader and timelier manner.

There has also been positive movement towards automation and transparency with the introduction of auto-borrow trades, as well as new ways of organising and collaborating in the marketplace. For example, lending providers are creating opportunities to interact more efficiently with brokers on multi-asset class trading platforms such as next generation trading. Rather than waiting for locates, agent lenders have been using technology to actively manage inventory with borrowers at market levels. This minimises back-and-forth correspondence and, once executed, generates STP tickets on both the borrower and lender sides. Automation has ultimately enabled agent lenders to focus on high intrinsic value opportunities and explore new trading strategies to optimise beneficial owner portfolios.

Prior to 2014, lending desks were dominated by Bloomberg messages, manual bookings and numerous lists sent directly to lenders. Today, a vastly different environment exists including capabilities to communicate lending availability files to counterparties at the start of the trading day. These files can contain over 5,000 securities prices from multiple markets across multiple collateral types. Counterparties can easily access inventory and book trades with an automated message to market. Technological change has enabled large amounts of data to be communicated rapidly from across the region to global desks. Both borrowers and lenders can now effectively deploy a 'follow-the-sun' servicing model, whereby Asian desks are passing their books to European and North American counterparts to ensure trades are being filled long after the markets have closed in Asia.

Securities lending is a highly competitive landscape globally, and Asia is no different. The region's markets continue to develop and adapt to an ever-changing environment, across all facets of the industry but especially on the technology front. Agent lenders who leverage technology to improve STP and work efficiently with the broker community are well positioned to rapidly identify lending trends that create value for clients. **SLT**

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