RBC Investor & Treasury Services

In the News

Donato D'Eramo, Managing Director, Securities Finance, RBC Investor & Treasury Services speaks to *Global Investor ISF* about indemnification, the rise in non-cash collateral and the influence of regulation on securities lending.

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In Canada and abroad, REGULATION continues to steer supply and demand

Donato D'Eramo, Managing Director, Securities Finance at RBC Investor & Treasury Services in Toronto speaks about the shifting tides of supply and demand, as well as the rise in non-cash collateral

Tell us about the types of clients you serve and what they look for in a securities lending programme.

As a securities lending agent, we act on behalf of beneficial owners that come from a diverse set of countries, regions and investment structures – including pension plans, asset managers, insurance companies and central banks – that adhere to different regulatory regimes.

They each have specific criteria both internally, in terms of return and risk, and externally from a regulatory perspective. We look to engage with them, understand their objectives and deliver tailored securities finance programmes.

As an agent for our clients, we are also connected to an extensive network of borrowers from various jurisdictions globally. Here we have certainly seen growing demand to borrow fixed income assets in recent years as the need for high-quality liquid assets (HQLA) increases. Today, fixed income to equity represents a 60-40 split compared to 50-50 a few years ago.

What influence has regulation had on demand for securities lending?

The story continues to be about growing demand for HQLA as regulation increases the importance of these assets to various types of participants. Regulations such as longevity risk transfer (LRT) and the net stable funding ratio (NSFR) are likely to push demand in specific areas – such as for collateral upgrades – as well as for financing liquidity needs more broadly.

Another regulatory and market concern is the emergence of central counterparties (CCPs) and the growing importance of collateral structures as part of the overall risk management framework. In discussions with borrowers, I don't think the infrastructure currently exists to make this a viable option on a significant scale. Collateral structures – such as pledge against title transfer – remain an important consideration for clients, including the potential to provide material benefit for borrowers when it comes to risk weighted assets (RWA). But in general this has not manifested as a major force.

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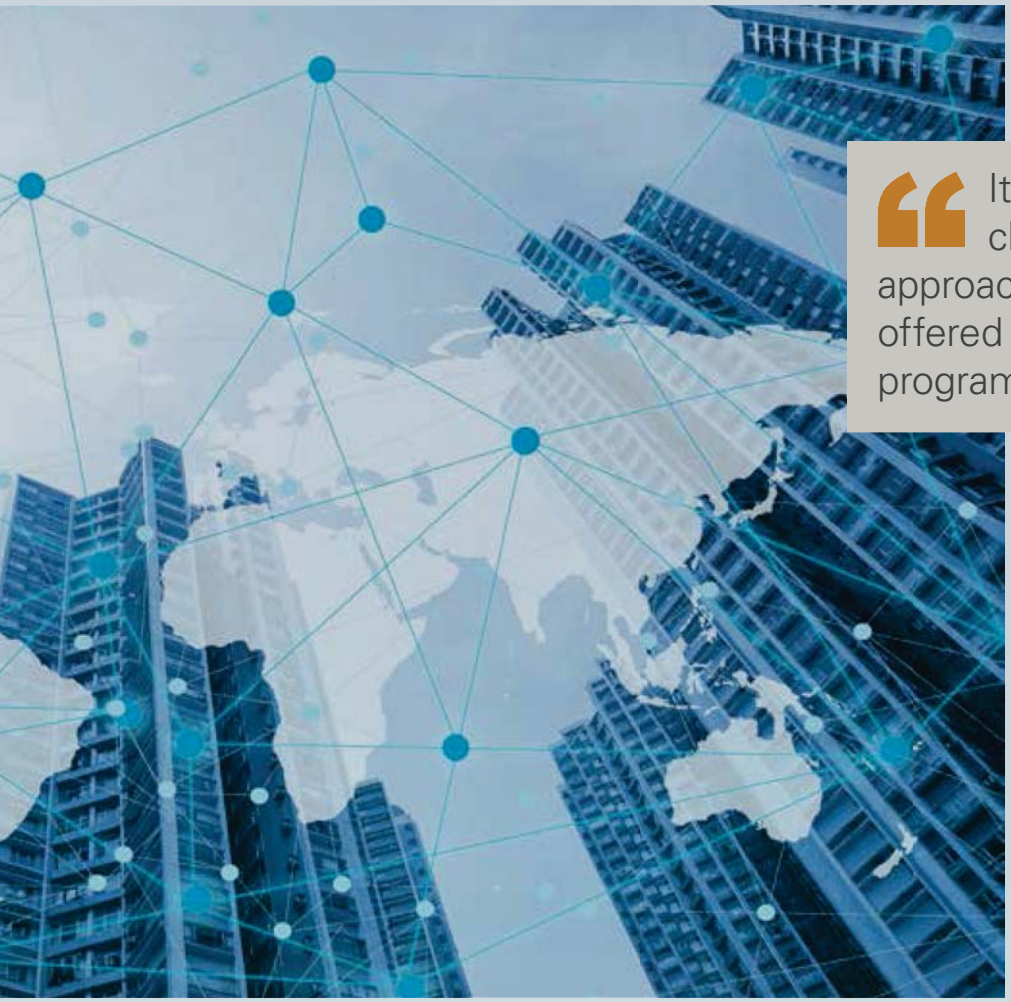
In Canada, the Office of the Superintendent of Financial Institutions (OSFI), for example, allows pension plans and insurance companies to accept equities



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as collateral. However, the regulations governing Canadian mutual funds – as stipulated by National Instrument 81-102 – preclude the acceptance of equity collateral. In the interest of investor protection, the unintended consequence is that mutual funds are unable to meet current demand for one to three-month term transactions where equity collateral is a factor.

We have also seen unintended consequences associated with regulation introduced following the financial crisis. One example in Europe is the UCITS rules that prevent funds from transacting in term trades longer than seven days.

As regulation increases the importance of holding HQLA – to meet capital and liquidity requirements – and pushes demand for term trades, we see benefits in allowing participants such as mutual funds to help close the gap between supply and demand.

To what extent is non-cash collateral growing in popularity?

In the US, cash collateral continues to be the largest section of the market and I believe that it will continue to play an important role. That said, its influence is decreasing as non-cash transactions gain ground. This may recently have been helped by the more conciliatory tone from US regulators – although structurally the trend predates this.

In any securities lending programme, it is important for beneficial owners to discuss the range of non-cash collateral with their provider in order to stay at the forefront of market demands as they evolve.

How do you demonstrate the value of securities lending to new entrants?

First, there are firms with long-term liabilities – pension funds and insurance companies, for example – which are well stocked with long-dated HQLA and wish to remain invested in these assets. If they are prepared to consider term trades at the asset class level, new entrants can look for programmes that substitute assets within the portfolio as market opportunities change.

Increasingly, a more popular route is for clients to lend on an opportunistic basis, with a particular transaction in mind. For one-off transactions, where the economics are clear, simple and confined, it is often easier to see the value. Moreover, the time to market is faster than the process of agreeing to guidelines for a general programme. One-off transactions may also be an effective gateway for clients to enter the securities lending market and become more involved in this sphere and may over time shift to a more comprehensive programme.

Is indemnification important to new entrants?

The question of indemnification has become particularly prominent for clients over the last two years. They are keen to understand why we are offering the indemnification, what it covers and what this means to them.

It is good practice for any client to understand the approach to indemnification offered in a securities lending programme. Insofar as permitted by the regulatory constraints that govern clients' acceptable collateral, we generally discuss the full suite of our offer and have found that the scope of the indemnification is typically more important to clients than the discussion around price.