THE SECURITIES LENDING MARKET IN 2021

A FINE BALANCE BETWEEN OPTIMISM AND UNCERTAINTY

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After the unforeseen shocks that dominated the world last year, any predictions for what 2021 will hold for the securities lending market come with a big caveat. Exogenous events still have considerable potential to surprise and disrupt. Yet there are also strong grounds for optimism.

WHAT WE GOT RIGHT ABOUT 2020

While initial projections for how the year would play out were quickly overtaken by the seismic spread of Covid-19, some of our predictions for 2020 have come to pass. One was the increasing importance of the Asia-Pacific region – where BNP Paribas Securities Services has continued to invest to support the securities lending market's growth, as with the recent addition of further trading capabilities in Hong Kong.

"Despite the temporary short selling bans in South Korea and Malaysia, the market continues to develop across the APAC region," notes Geggus. "This evolution is exemplified by the recent introduction of facilitated short selling and margin financing for global investors in China via the Qualified Foreign Institutional Investor scheme."

We also expected further robust borrower demand for eligible collateral securities and high quality liquid assets (HQLA), primarily to meet industry participants' regulatory requirements. This trend played out through the year. There was increasing interest in collateral flexibility and optionality around tenors, with those beneficial owners able to accept a wide range of collateral on wide tenors proving best placed to benefit from demand for these asset types.

"It is a trend we do not see diminishing," says Geggus. "Collateral and tenor flexibility will become ever more important factors in the profitability of beneficial owners' portfolios."

The other major development we pointed to in 2020 was implementation of the European Union's landmark Securities Financing Transactions Regulation (SFTR), which imposes extensive reporting and transparency requirements on lenders and borrowers. It is one of the largest regulatory undertakings the securities finance industry has faced in recent years and has required considerable resources to prepare.

"Successful implementation of such a complex piece of regulation is testament to the work performed across all market participants and between the industry working groups," notes Geggus.

WHAT DOES 2021 HOLD?

So what can we expect from the year ahead? The outlook is for a fine balance between uncertainty and optimism.

Covid-19 impact will linger on

Vaccination programmes are rolling out apace. Yet rising infection rates, the spread of new variants and need for ongoing suppression through extended curtailment measures mean there is still no clear route out of the global health crisis. How long the impact of Covid-19 will be felt, and the full extent of the scarring it leaves behind, remains to be seen.

"Until that picture becomes clear, enormous doubt hangs over the global economy and the prospects for a normalisation of activity in the months and years to come," says Geggus. "In the meantime, central banks and governments will continue to pursue their extraordinary stimulus programmes – in turn exacerbating the questions around how countries can sustain and eventually address the current levels of debt, and whether the huge liquidity injections can be rolled back without impacting the economy and jobs," he adds.

As for the securities lending universe more specifically, the prospects through the current year and beyond are bright.

"We are seeing more asset owners and asset managers than ever engage in discussions about entering securities lending programmes," says Geggus. "New markets are opening up to securities lending and new routes to market continue to be explored. We are also seeing technological and efficiency developments that will help drive our business into the future."

A big focus in recent years has been on automation and STP, and that will continue to grow, he explains. "More recently, we are seeing new developments in distributed ledger technology, artificial intelligence and machine learning, all of which promise exciting times ahead for the securities lending industry."

Regulation will test programmes' effectiveness

Regulation will be another major factor influencing the landscape and level of activity. Following the SFTR implementation, the industry's focus for the coming year is turning to the Central Securities Depositories Regulation (CSDR), with the market efficiencies it promises through mandatory buy-ins and late settlement penalties.

"With the regulation due to go live on 1 February 2022, the market continues to seek clarity on its final scope and to understand all the implications of the potential automatic buy-ins and punitive charges," says Geggus. "Operational efficiency with automated loan and recall processes will become ever more vital, and will be a key contributing factor when pricing loans."

Balancing ESG and securities lending priorities

A further trend coming to the fore is the focus on environmental, social and governance (ESG) issues, which in recent years have gone from a minor additional consideration to top of the agenda.

"Clients are much more actively engaged in conversations focused on ESG and how agent lenders can support them in pursuing their ESG goals," Geggus notes.

How this heightened focus will play out for the securities lending industry is not yet clear. But with no one-size-fits-all ESG solution, demand for service customisation is likely to increase.

"In an industry that has been working towards an omnibus structure, and bulking clients' assets together versus groups of pre-approved collateral sets, we can expect a needed shift to large scale customisation" says Geggus. "The industry will need to develop customisable approved collateral and increase their recall capabilities to align with the clients' desire to vote more." Two areas where the bank stands ready to support its clients.

As with any change, incorporating ESG will be a test for the industry. "I believe ESG is a real driver for good and we will see a shift more broadly towards goals for sustainable finance," Geggus says.

IMPACT ON LENDERS' PROGRAMMES

How the events of 2021 play out will present challenges and opportunities for market participants. To what degree the challenges can be addressed and opportunities maximised will be determined to a large extent by lenders and their agents.

"The impact on programme revenues really depends on what clients are looking to achieve," says Geggus. "For example, agent lenders can support their clients' pursuit of ESG policies while offering ways to optimise the revenue generated. Clients wanting to vote will have to put in place recall programmes, a good agent lender can work with them to achieve that, all the while maintaining their programme's performance."

Geggus' suggestion for any prospective lender considering entering the securities lending market is to decide whether they want an agency or principal programme. Then discuss the programme goals with the lending provider and tap their expertise to increase revenue. "Whether it is through greater flexibility of collateral or allowing term trades up to a specific tenor, there are many ways in which an experienced securities lending partner can help lenders maximise performance."

CHANGING WITH THE TIMES

Performance optimisation is a goal BNP Paribas Securities Services is constantly striving towards, as we adapt our securities lending service to accommodate market developments and our clients' priorities. Sustained investment in our technology and people is key to that focus.

"We continually seek to improve the efficiency of our business through technological advancements, along with ensuring we have the best people to support our clients across the globe," says Geggus. "This is not just a short-term investment. It is a long-term commitment. The industry is ever changing and being able to adapt to it is vital if we are to keep improving the benefits our clients gain from securities lending."

The aim for Geggus is to cement the bank's position as a technology market leader and to lead the way in partnering with clients to support their ESG goals and ambitions, all while taking a prudent approach to risk. "Our clients are at the forefront of all our business decisions and developments," he says. "When they succeed so do we."

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