Crossing borders

Michael Saunders, head of agency lending for the Americas at BNP Paribas Securities Services in New York, tells GI/ISF about its move to integrate cross-border flows into securities lending programmes, and the widening application of technology to all elements of the sector, including the fast-growing segment of ESG.

What internal changes are improving what your clients can expect?
In recent months we have seen several initiatives come to fruition, whose implementation began prior to the pandemic. These have strengthened our offering as an agency lender and, most crucially, enhanced the performance our clients can expect across all segments – from central banks and sovereign wealth funds through to leading asset managers, insurance companies and corporates.

The focus of several of these initiatives has been the integration of cross-border flows, leveraging our four different office locations in New York, London, Hong Kong and Sydney. This has improved the ability of local trading desks to employ all the assets held across a client's portfolio in securities lending transactions. In a low yield environment, the additional returns available to beneficial owners by maximising the use of their assets, wherever they are domiciled, is more important than ever.

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What are the challenges of incorporating Asian assets into securities lending programmes?
The launch of our Hong Kong desk expanded our footprint in Asia. This is a continent where clients are seeing an increasing concentration of new investment opportunities and from where the effective mobilisation of assets for securities lending transactions has become increasingly valuable.

It is hard to overstate the importance of expertise in these new markets. Given the barriers to entry for clients, arising from the varied characteristics of execution and settlement across the region, they typically require a highly bespoke service. Our footprint in the region, established through our existing asset servicing businesses, means that we are familiar with precisely how the local regulatory and processing architecture is arranged.

This familiarity has been accumulated via a long history in the region: our lending desks

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are just the latest addition to a servicing infrastructure that stretches back many years. This history began with our custody network, through which we have developed a granular understanding of the local regulations and often highly bespoke settlement processes. In turn this understanding has allowed us to support credit opportunities and expand the range of products developed by our teams on the ground. In other words, the BNP Paribas flag had long been planted: the recent establishment of our securities lending desk has allowed clients to harness this existing network, monetising assets in their securities lending programmes that historically they had been unable to use.

The benefits become clear when you consider the case of a US client owning Hong Kong or Australian assets. Given the time difference and the lack of a local presence, the practice of placing those assets on loan previously was very rare. It involved going through European or US brokers, with the opportunity set limited to intrinsic-based lending. Clients therefore often missed out on high fee opportunities presented by assets they owned that were in particularly short supply.

Today, for clients domiciled in regions beyond Asia, utilisation of Asian assets has increased. And this isn't just around specials. Unlike other providers, whose balance sheets may restrict them in supporting lower-margin collateral transactions, we can support general collateral trades. We are approaching a point where we are genuinely agnostic when it comes to where the client is based. Our mind-set has shifted to the domicile of the asset rather than the location of the client.

Why is seeking out additional liquidity important to clients now and how are you helping them achieve it?

Working to better identify hidden pockets of liquidity for our clients is a second area where we have recently been focusing our efforts and one which closely supplements this more global lending model previously discussed.

With such an excess of liquidity in the market, clients continue to find it very difficult to discover short-term investments or collateral types that offer a competitive yield. The current records being set in the use of the US Federal Reserve reverse repo programme, where daily deposit balances were more than $750bn in late June, despite the programme offering a zero-interest rate, demonstrate this conundrum. (Please note record usage exceeding $765 billion daily following the recent FOMC action to raise the RRP floor to 0.05%)

It falls to agent lenders to do everything within their power to search out additional revenue opportunities. This includes forging partnerships with leading technology vendor's and we have recently struck an arrangement with execution vendor HQLAx, an investment that dramatically improves our ability to identify liquidity opportunities of this type. It is one of many partnerships we have with vendors that improve our ability to tact pockets of liquidity.

What is the contribution of collateral transformation to these efforts?

This is another area in which we have invested heavily in recent years, in response to the growing demand for HQLA. Providing the means by which clients can lend such assets against other high-quality liquid assets means releasing an important source of

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additional return without exposing clients to a deterioration in creditworthiness.

Consider the case of lending out US Treasury bills in exchange for UK gilts and earning a spread from the trade. This may only generate seven or eight basis points of spread but at the scale of $1bn or $20bn the revenues that accrue can be considerable. In addition, this is a stable and predictable revenue stream, making it a valuable additional strategy that can be incorporated into a securities lending program. We've seen great traction here recently with a range of clients from central banks and sovereign institutions to large asset managers.

Another particularly popular shift recently has been the growing practice of assisting clients with the investment of their short term excess cash outside of their lending programme. Utilizing our existing infrastructure and expertise to find pockets of opportunity in the short term interest rate space in accordance with defined risk parameters has proven to be impactful in fortifying existing client relationships. Once again, this is being driven by the low-yield environment. Across the board, beneficial owners such as corporates, pension funds and sovereign wealth funds are all long cash and are looking for ways to use it. Our offering provides a solution to this problem, giving a short-term management tool able to generate enhanced yield over traditional money market products including money market funds, Treasury bills or term deposits.

How are you helping clients find ways to reinvest cash collateral?

Much of what we've discussed so far has focussed on lending an asset and receiving the cash or non-cash collateral in return. An important second leg to this process is reinvesting collateral when it comes in the form of cash. That is where our new product Directed Agent Repo Liquidity Solution (DARLS) is relevant. . It allows us to leverage our strengths in infrastructure, documentation and risk monitoring, and our operational support network.

DARLS means that we can invest cash on behalf of the client in the market via a list of approved counterparties while providing an indemnification against counterparty default. This combination ensures the investment is secure and highly customised in terms of tenure and approved collateral. It works almost like an ancillary business leveraging off the agency lending desk, offered to clients of the bank within their existing program and focussing on the excess cash they are looking to deploy. In effect, it means clients can outsource liquidity management on a daily, weekly, monthly or quarterly basis and we have already seen the product gain a high degree of traction among our clients.

How important is ESG becoming and what specific challenges does it impose when it comes to securities lending?

The issue of ESG could hardly be more topical. It is an agenda item on every client review, and every proposal we read contains a section devoted to it. Across the investment industry, the question of whether an ESG strategy is producing a tangible impact in the world is under considerable scrutiny.

When it comes to this growing demand for transparency, securities lending is no exception. In our sector, the focus lay initially

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on issues such as recalling securities for proxy measures – such as AGMs and other votes – and most agent lenders today are able to accommodate requests of this kind.

But industry efforts are now expanding into areas such as how quickly and easily ESG-approved collateral sets can be processed. . We are heavily involved in these efforts both within our organisation and at industry bodies to not only monitor the ongoing development but assist in the shaping of pertinent parameters to apply ESG criteria to a securities lending programme. Our involvement with the industry working trade groups combined with the focus of BNP Paribas to become the leader in ESG enables us to be well versed in the issues that matter to both the agent lender and the beneficial owner communities. At our core, BNP Paribas' ambition is to participate in building a more sustainable future. As a leader in the ESG space, we believe we have an important role to play which is highlighted by our global initiatives. These ambitions are core principals of all our businesses and we strive to incorporate this into the management of our securities lending programme.

To achieve ESG compliance in securities lending programmes requires a robust infrastructure on the part of the agent lender, supporting buffered access and imposing restrictions on incoming collateral. Here, our position as a leading custodian puts us at an advantage since that infrastructure is securely in place. We are accustomed to providing highly bespoke and customised solutions when it comes to shifts in client demands, such as the recent trend for placing restrictions on specific asset classes or names. Here again we are in discussion with several external technology vendors in this space further to improve our offering.

How far can technology play a role in scaling these new offerings?

In part due to many of the trends that we have discussed here, we anticipate significant growth to our agent lending business in the coming months and years. A high level of automation is required to facilitate that growth whilst maintaining the highest quality of service. It is no secret that increasing automation in the securities lending process to remove time consuming manual elements is an important priority for providers and clients alike across the sector. We are pursuing our strategy to achieve both, by developing solutions internally and by expanding our partnerships with external providers.

In the second case we are in discussions with a number of external firms who are pioneering the latest applications of technology, such as AI. The application of technology has made big inroads already in sparing teams the monotony of manual processing across almost every element of the trade lifecycle, including processing recalls and their return elements and all components of corporate actions. But there is a lot agent lenders can still do to make the securities lending processes more streamlined, more efficient and faster. Harnessing the cutting-edge solutions provided by external specialists is an essential way to harvest the additional benefits on offer. Like all agent lenders we are working hard to make this element more streamlined and seamless. ■