



The Evolution of Securities Lending

Transcript

Murray Bender:

RBC Investor & Treasury Services is pleased to present "Insights on the Opportunities and Challenges Facing Financial and Other Institutional Investors." Today's podcast features Don D'Eramo, Global Head of Securities Finance at RBC Investor & Treasury Services, sharing his thoughts on the evolving securities lending business. Don, thanks for joining us today.

Don D'Eramo:

Thank you, Murray. It's my pleasure to be here today and engage in this discussion on the securities lending industry.

Murray Bender:

So let's start with the basics. What do you see as the key drivers of securities lending?

Don D'Eramo:

They say the first securities lending transaction happened in the 1960s in the City of London where, you know, the first loan was executed, really to cover settlement failures. We fast forward today. Obviously a much more complex industry moving from what, you know, is called securities lending for failed trades, to what now we call is an efficient portfolio management process. Moreover, \$30 trillion in assets are enrolled in securities lending today. And on any given day, we have about \$3 trillion on loan in the industry. If you look at the drivers, you know, one of the drivers is still settlement failures. But again, the complexity of the industry has made that much broader.

You see drivers along the lines of financing, you know, mobilizing high-quality liquid assets for regulatory demand; collateral optimization; you have ETF creations that create demand for securities lending; and also hedging. Hedging of derivatives, hedging of any positions. You have corporate actions or corporate activity, mergers and acquisitions, which would lead for drivers of demand. And also facilitating investment strategies, complex investment strategies like long shorts, as an example, where there is a short component to a leveraged strategy. And again, securities lending is a driver there from a demand perspective.

And lastly I would say, even if you look at central banks around the world, central banks will use securities lending to execute on certain monetary policy or even liquidity strategies they may have.

So all of this really underpins what I believe is the crucial role of securities lending. It plays a very, very crucial role around price transparency, price discovery, and secondary liquidity. All this then leads, really, to opportunities for beneficial owners to earn a fairly low risk, you know, adjusted return on idle assets without really impeding any of their day-to-day investment strategies.

Murray Bender:

So, Don, what do you say to beneficial owners who may have concerns about securities lending?

Don D'Eramo:

I would bucket concerns, would talk to clients and prospects and stakeholders around a few different themes: risk is always top of mind; regulation is top of mind; revenue; and operational processes.

So as I said, you know, in our industry, specifically with RBC I&TS securities lending program, we offer an indemnity to our clients from counterparty default. So that really allows our clients to earn revenues at a very low risk, in a very low-risk environment. So educating them on the risk rigour that RBC I&TS has around collateral counterparts and the capital behind our indemnity is very, very important, and a theme that clients do like to understand better. Revenue obviously; what type of revenue, how they can earn revenue is a theme as well.

And then regulations. You can have various different regulations that impact certain sectors of clients, whether you're, as an example, a mutual fund and national instrument regulation, so ensuring that our program meets the regulatory requirements is also a theme that clients would like to talk about.

And then probably key as well is around operational. How does the lending of my securities in my portfolio impact my day-to-day investment strategies? And given that with RBC I&TS we have almost a trillion in lendable assets, the ability for us to produce a program for our clients that is transparent to their day-to-day investment decisions, is a very sought after tenet in our program.

And equally to that, I would say, Murray, is the program that we run is really to understand those concerns and their risk appetite and really tailor a program around that, whether it's the types of assets we lend, who we lend to, and how we lend them.

So all of that is part and parcel of what we do. And I think what's also equally important that clients are concerned about, when I go back to the risk issue, is our program is very resilient. It's lived through, you know, credit shocks, the credit dislocation of 2007/2008. It's lived through the sovereign bond crisis. We're now in the COVID pandemic. Clients have not experienced any losses. And so understanding how we approach risk I think is a very key theme or concern that clients have. And we do our best to ensure that they have that full picture on how we run the program for them.

Murray Bender:

Sustainability is very much front and centre these days. How is the securities lending business dealing with sustainability and ESG?

Don D'Eramo:

I think I'll answer ESG with another "E" word and that's engagement. We spend a lot of time engaging our clients today on various different themes, regulatory or otherwise. And ESG, the environmental, social, and governance aspect of sustainable finance is very front of mind. And engaging with our clients, or engaging with the industry at large, is really a focus of ours at RBC today with our lending program.

Our current program has a very strong governance regime around it. So one of the key themes around ESG is proxy voting, as an example, and ensuring that the governance around proxy voting is fulfilled. Well, within our program we've always dealt with that. So the ESG component today isn't any different as to how we offer a program to our clients. So clients are free to recall their securities, as an example, for a proxy vote. And we can accommodate that within our current regime.

So I think the way we run our program today, you know, it fits very well with the discussion in ESG. It's an evolving discussion, I would say, specifically when you think about the environmental and social aspect of it. So that discussion continues to evolve in the industry.

And so I come back to my engagement point. We have partnered with the International Securities Lending Association, and we sit at the table of Council of Sustainable Finance. We're there to help shape the discussion. We're there to help bring the voice of our clients when it comes to the ESG discussion. And equally, you know, through industry associations like CASLA, we are also at the table with the global PSSL, PSSL standing for the Principles for Sustained (sic) [Sustainable] Securities Lending. So the opportunity today exists for us to be as engaged as possible in an environment where ESG definitely is here to stay. And having a voice in helping shape the principles and themes on behalf of our clients, and ensuring that the industry and product continues to evolve is very, very important for us.

Murray Bender:

As you mentioned, we're currently in the midst of a pandemic. From your vantage point, what impact has COVID-19 had on securities lending and how is the industry responding?

Don D'Eramo:

I would say, Murray, from the pandemic and COVID perspective, obviously in the early days, volatility was front and centre of mind, volatility in the marketplaces. And that volatility led to the underlying clients increased volumes of transactions.

So the theme I talked about at the beginning around some of the concerns and drivers that clients have was around operational. So we saw a very, very spiked increase volume of transactions, which then led to a lot of recalling in the industry with respect to clients readjusting their portfolios based on risk views that they may have. So that translated into a lot more volume in the lending world, whether as loans or as recalls. But what was interesting is we did not see, at RBC, an increase in failed trades. So that speaks fairly significantly to the ability, even in a high volatile environment, to be able to operate our program without disrupting client activity when it comes to the client readjusting their internal risk views and potentially adjusting their portfolios.

So that was one thing we definitely saw. And the thing I'd say is, you know, securities lending itself is a very, very resilient industry. It does react to, you know, the macroeconomic drivers of the day and COVID and the pandemic isn't any different. So we saw, you know, a spike in demand for high-quality assets. We saw a spike in demand in certain sectors, again, because of the macroeconomic views of clients, whether it's the aviation sector or tourism. So we definitely saw spikes in demand in various sectors that correlated to that environment that clients were looking to readjust their portfolios. So I would say that the industry, you know, is resilient in that manner. As I said, it's gone through various different, you know, macroeconomic shocks and, you know, we at RBC have never had a client that's lost any money based on any of those scenarios. And I think that speaks volumes to the risk rigour and how the program is run today.

Murray Bender:

So finally, looking to the future, how do you expect the securities lending business to evolve as we move forward?

Don D'Eramo:

The future, I think, is very interesting. I mean, as I said, it's a mature industry. It's already been tried and tested, but I think it continues to evolve and that's the beauty of this industry. And within RBC we continue to ensure that the product evolves with the industry. So I would say, you know, I would bucket it under three different things.

You think about regulations. We've just gone through, and continue to go through, probably the largest regulatory change in securities lending, and that's the Securities Finance Transaction Reporting (sic) [Securities Financing Transactions Regulation], SFTR. And we've delivered that in the first phase. And now at the end of October we'll begin reporting

on behalf of clients. SRD2, another European regulation that's come into play now, in September, you know, is really at the centre of transparency and issuers' transparency of shareholders. So, again, strengthening that ESG theme and commentary in the business, in the industry.

And then, in the near future, we're looking at, you know, CSDR and other various, you know, penalty settlement regimes, which I think will continue the theme of efficient settlement and efficiencies around settlement, which I think is a positive for clients generally and will help the industry engage with more clients in the future. So I think regulations is definitely one theme.

And a second theme, outside of regulation that will probably shape the future of the industry, Murray, I would say, is data. What I mean by that is the consumption of data. Our clients, you know, are looking to consume securities lending data in the future in a much more efficient manner, enabling them to make better decisions with respect to their mandates. And what I mean by that is, you know, ingesting securities lending data to ensure that they're optimizing what they want to achieve. Remember that, you know, we look to optimize our mandates based on our clients' risk appetites. So I think data, the theme of data, moving forward, will be front and centre within the industry and how it develops.

And then lastly I would say, you know, we talked—we touched about ESG, but the themes around sustainable securities finance I think will continue to become more front and centre. One thing I would say with that is even through the pandemic and COVID that discussion never really did mute at all. It continues to evolve.

So I would say between regulation; data, and the utilization of data on behalf of our clients; consumption of data and how we provide data; as well as that sustainable finance discussion, I think are three themes I see continuing to evolve in the future for the industry.

Murray Bender:

Very interesting times indeed. Thanks for your time, Don.

Don D'Eramo:

It's been my pleasure, Murray. Thank you.

Murray Bender:

We've been talking to Don D'Eramo, Global Head of Securities Finance at RBC Investor & Treasury Services about securities lending and its important role within the financial services industry.

Today's podcast has been presented by RBC Investor & Treasury Services, and we hope you found it useful. For additional insights on topics of interest to financial and other institutional investors, visit RBCITS.com/insights.

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