Asset Managers making securities lending mainstream

While the global securities lending market all but closed in the aftermath of the global financial crisis, the past decade has seen it come back strongly. But according to buy-side representatives speaking at the Euroclear Collateral Conference in Brussels in November 2018, there are several hurdles they face, before they can say that securities lending has become mainstream.

According to a survey by DataLend, a research provider, the securities lending market produced revenues of USD 9 billion in 2017; maybe not huge in the overall revenue mix of the global asset management industry, but still a sizeable source of additional 'easy' revenues. New market forces are reshaping the global asset management industry, providing astute lenders with interesting new opportunities.

One such is the move to scale, via market consolidation and asset gathering.

Consolidation time

One firm that has recently consolidated is Aberdeen Standard Investments, formed by the merger of Aberdeen and Standard Life Investments.

According to Matthew Chessum, an Investment Manager within the liquidity team at Aberdeen Standard Investments, the firm has spent the last year integrating two separate collateral and securities lending programmes.

Although this takes considerable operational resources, the sense is that it is worth it.

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Matthew Chessum,
Aberdeen Standard Investments

"You cannot have a fully functional collateral management programme without an element of securities lending," he says. "We want to make it as efficient as possible and minimise performance drag, we cannot rely on the banks to do the heavy lifting for us."

The focus on securities lending comes at a time when the overall push for collateral has never been greater.

Integrating to safeguard liquidity

With interest rates rising and global liquidity shrinking, many asset managers feel there is time pressure on them to improve their overall collateral systems and their securities lending programmes.

"We have spent two years rolling out our collateral roadmap, and it will take two years more before it is complete," says Roelof van der Struik, Investment Analyst-Manager Treasury Trading & Commodities at Dutch integrated asset manager and pensions specialist PGGM.

"We are building our own plumbing so that we know we can get liquidity when we need it."

On a practical level, to optimise their securities lending programmes, asset managers are having to make some profound organisational changes, which again take time and effort.

Most important is the integration of various pools of collateral, be they on the securities lending desks, repo desks or treasury desks.

"We are continuing to integrate our desks, so we can optimise collateral management and securities lending, as we want to safeguard liquidity when interest rates start to rise," says Xavier Bouthors Senior Portfolio Manager for NN Investment Partners' Treasury Fixed Income Solutions.

Balancing benefits and risks

Within the trend of better collateral management, however, securities lending will still be judged on the risk return profile it presents both to the fund that is lending and the manager who runs the fund.

And this is where the nuances start to appear.

"When we have an attractive portfolio of assets to lend on behalf of a client, if the risk-weighted asset requirements don't make sense, it just will not happen," says van der Struik at PGGM.

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Other managers agree that the balance of the risks and the rewards inherent in the securities lending business are key considerations.

"For us to do it, it has to be beneficial to the fund," says Chessum at Aberdeen Standard Investments. "But it is a small part of our business and if the board thinks it is too risky then we will not do it."

Reporting duty

The interplay between the push for consolidation, the greater focus on collateral management and the heightened sense of market and counterparty risks can be best seen with the EU's upcoming Securities Financing Transactions Regulation (SFTR).

Those asset managers that want to participate in securities lending will need to report their trades to a central depositary, via the provision of 153 separate pieces of data – for each and every trade. For many smaller asset managers, this burden seems onerous, and many could decide to eschew the securities lending business altogether.

But for larger managers who have the scale and competency to integrate this work in their business, securities lending could become even more attractive.

"I think a standard way of reporting securities lending is a good thing," says van der Struik.

Lending and responsible investing

One further hurdle that asset managers are confronting when looking at their securities lending programmes, is the concerns of their underlying clients as to the ethics of the business.

Securities lending has largely been undertaken by asset managers and beneficial owners lending equity to hedge funds so they can short individual or baskets of stocks.

The rise in demand for responsible investing products has seen some beneficial owners commit to not lending their shares.

It is a challenge that firms are trying to square.

"We are working on integrating securities lending into a wider push for responsible investing and engagement," says Bouthors at NN Investment Partners.

"New portfolios are being launched with a sustainable focus that do not lend. We are active managers and therefore if securities lending adds performance and a way for us to differentiate from passive investments, it is value to the portfolio."

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Growing in global finance

The next few years of activity in the securities lending market will see individual asset managers grapple with all these competing forces: the need to integrate resources as part of the push for size and collateral, the needs of the fund versus the needs of the manager, the balance between the perceived risks and rewards and the ethics of the business.

It will likely lead to a larger, more centralised, standardised and transparent market, firmly in the mainstream of global finance.