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Routes to the Securities Lending Market

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In the previous article we covered the key topics investment managers need to consider when deciding whether to lend their securities. Here we look at the various routes to the market that should be considered once you have decided to lend. The organisational and portfolio characteristics are significant factors in determining the feasible routes to the lending market. Given each investment manager's motivations, portfolio characteristics and investment strategies, risk appetite, middle and back-office setups and the supporting technology, the route taken by one investment manager may not necessarily suit another firm that has decided to enter the lending market.

As the lending business has evolved from a back-office to a front-office activity, the supporting technology and infrastructure have historically not kept up with the demands of the business. Most of the market still relies on legacy infrastructure and post-trade processes that favour certain incumbent service and technology providers. However, this landscape is changing, therefore, new entrants do not need to feel constrained by the old operating models as better technology now offers investment managers more options for setting up and maintaining efficient business processes. The possible routes to market are:

1) In-house lending agency;

2) Custodian operated programme (discretionary or agency lending);

3) Third-party agency programme (discretionary or agency lending);

4) Portfolio auctions (exclusives);

5) Lending to a single principal borrower (lending to a single borrower or a select group)

6) Direct (peer-to-peer, all-to-all) lending;

7) Lending via CCPs (not a route to market on its own. An attractive post-trade option for some borrowers); and,

8) A combination of the above – the above options aren't mutually exclusive and some of the options may only suit certain types of portfolios, therefore a lending programme with multiple paths might be optimal for certain investment managers. For example, you can enter certain markets via exclusive lending, lend certain portfolios to a single principal based on minimum fees, lend general collateral assets via your custodian and hard to borrow "specials" via direct lending or a third-party.

Assessing multiple routes to market in order to optimise the benefits from, and achieve a joined-up view of, your broader securities finance activities is critical. Developments in the pre- and post-trade technology space enable investment managers to choose among various service providers when setting up an in-house programme or lending via a service provider. Furthermore, as the technology supporting the lending lifecycle evolves, the resulting automation will enable the front office to obtain a holistic and near real-time view of the inventory and collateral and will ease the burden of regulatory reporting obligations such as SFTR and CSDR.

When assessing the various routes the focus must be on: a) the returns (financial and market colour) from the programme; b) the optimised performance you can achieve based on the risk parameters; c) the management/reinvestment of collateral (cash and non-cash) as part of your investment management discipline; d) the expertise and infrastructure support available in-house vs those offered by the service provider(s); e) the reputation and performance of the service provider(s) executing all or components of your programme; and f) the running and maintenance costs of the lending programme, including managing your internal oversight and governance activities.

Conclusion

Selecting the best route to market involves assessing your programme requirements against various constraints in order to deliver the most optimal returns within those parameters. An independent, business process-based and service provider-agnostic assessment of your objectives and options will offer clarity and enable you to make the right decision. In the next article, we will cover the critical risk management and governance topics associated with securities lending programmes.

Please contact us directly at Margin Reform to discuss the pros and cons of the routes to market available to you, given your programme objectives. We can provide independent assessments, assurance and help you make informed decisions in selecting the most suitable approach.

If you would like further information on how we can help you, please drop me an email sakti@marginreform.com or give me a call on +44 7887 637445.

Recommended reading

International Securities Lending Association (Mar 2019), The Institutional Investor Guide to Securities Lending
https://www.isla.co.uk/wp-content/uploads/2019/03/ISLA_Industry_Guide_Institutional_Investor_September_19.pdf

Global Investor Group (May 2019), A fresh look at lending
https://www.globalinvestorgroup.com/articles/3692363/a-fresh-look-at-lending

SLT (Sep 2018), Taking the Right Route
http://www.securitieslendingtimes.com/specialistfeatures/specialistfeature.php?specialist_id=287