



# 2021 RMA SECURITIES LENDING OUTLOOK

At RMA's Securities Lending 2021 Outlook Conference in January, participants, presenters, and panelists discussed the industry's challenges and opportunities. Below is a summary of the conference sessions - and things to keep an eye on this year.

## SESSION: GLOBAL REGULATORY UPDATE AND OUTLOOK FOR 2021

**Moderator:** Greg Lyons, Partner, Debevoise & Plimpton, LLP

**Panelists:** Paul Tagliareni, Executive Director, Morgan Stanley; Jane Wagner, Global Head, Securities Lending Program, Vanguard; Glenn Horner, Managing Director and Chief Regulatory Officer, State Street

Along with changes to personnel, there will likely also be a shift in approach at the regulatory agencies under the Biden administration. At the Federal Reserve (Fed), Vice Chair for Supervision Randal K. Quarles is expected to step down in 2021, which could have implications for bank, given that this position sets the direction for the Fed's regulatory agenda. Secretary of the Treasury Janet Yellen, a proponent of more government stimulus, will serve as head of the Treasury's Financial Stability Oversight Council, driving its agenda. The council was more relaxed and relatively inactive under the Trump administration, and the industry is waiting to see if Yellen promotes more oversight and regulation in areas such as mutual funds, which could impact the securities lending industry.

Regulators are focused on non-crisis-related rulemaking and policy. Of particular interest to the banking industry is the net stable funding ratio (NSFR) final rule, effective July 2021. The rule requires certain large banking organizations to maintain minimum amounts of stable funding to support their assets, commitments, and derivative exposures over a one-year time horizon. Compared to the proposal, the final rule provides more favorable treatment for certain affiliate sweep deposits and non-deposit retail funding. Although most firms would be in compliance if in effect today, the rule places yet more strain on bank affiliated dealers' funding models.

Also of concern is Basel III, Part 2, (or Basel III End Game or Basel IV), which refers to the Basel Committee on Banking Supervision's revisions to the Basel III framework at the end of 2017. This package of reforms seeks to enhance the robustness of the standardized

approaches for credit risk (including by introducing a more risk-sensitive methodology for quantifying exposures arising from securities financing transactions and potentially more risk-sensitive risk weights for corporate counterparties), credit valuation adjustment risk, and operational risk—and constrains the use of internal models. Other key changes include increased granularity and risk sensitivity and reduced reliance on credit ratings. The federal banking agencies have been working on a proposal for the past two years, and are expected to publish a final rule in the next year or so.

*The following are the questions asked by attendees, each of which were answered by an event participant.*

### **Q: What is your view on changes at the SEC and do you think any of the changes will impact the E4E effort?**

**Greg Lyons:** While we know he will be tougher, it is very difficult to know the exact implications of a Gensler commission. That said, we expect his primary focus to be on investor protection, and in particular rolling back some of the reductions of investor protection under Clayton. We are not aware of any particular reason why he should seek to limit E4E.

### **Q: Is there more likely to be more pressure to increase transparency in securities lending from the SEC such as the 984 reg from way back when?**

**Greg Lyons:** Gensler clearly will be focused on investor protection issues, ranging from proxy access to public disclosure requirements. While he favors heavier regulation generally, it is difficult to say how he will react to relatively more obscure issues like securities lending disclosure. On balance, I think he would favor more disclosure, but also do not think this will be a priority for him.

### **Q: Will hedge funds receive more scrutiny and reporting requirements? Will 'best execution' impact them?**

**Greg Lyons:** Gensler believes that the Trump Administration went too far with deregulation, and is very focused on investor protection. With that said, he likely will be more focused on retail investors, as

opposed to hedge fund investors, as well as the potential intersections between the two (e.g., the GME short squeeze).

**Q: Do you see US regulations around ESG evolving along the lines that we have seen in Europe?**

**Greg Lyons:** ESG will be a focus of the Biden Administration, and Gensler is expected to follow suit, but sweeping change may require significant legislation, which may be difficult to push through Congress. At a regulatory level, a big focus may be disclosing more ESG considerations in public filings, but it also will likely appear in other areas.

## SESSION: GLOBAL SECURITIES LENDING MARKETS AND STATE OF THE INDUSTRY

**Moderator:** Grant Davies, Head of Sales EMEA, Equilend

**Panelists:** Matthew Collins, Co-Head of Securities Lending for the Americas, Morgan Stanley; William Kelly, Managing Director and Global Head of Agency Securities Finance, BNY Mellon; Sandra Linn, Senior Vice President, Head of Securities Lending—North America, Northern Trust; Martin Tell, Senior Managing Director, State Street

Markets hit a low point in the midst of the March and April selloffs, driven by pandemic-related factors. But green shoots in the form of activity in initial public offerings (IPOs) and the capital markets began to emerge in the second half of 2020, giving market participants some optimism heading into 2021. The fourth quarter saw significant increases in financing demands, along with greater breadth and depth around particular industries and demand in equities. New markets are opening up in hedge funds, which had a strong 2020.

Reinvestment income fell significantly in 2020 as interest rates dropped to zero percent. There was also a shift in the market, from equities with higher spreads to fixed income with lower spreads, as well as a shift to noncash collateral. These factors make it challenging to find high-value securities.

A return to the market of scrip dividends with the opportunity that provides to securities finance could have a positive impact on industry performance. In 2017 it contributed about 17%. While it may not be on the same scale for 2021, it would certainly be a welcome inclusion.

Also at play for the industry in 2021 is a heightened focus on environmental, social, and governance (ESG) investing. Clients are looking for new ways to express ESG principles in their securities lending programs. Although there is no one-size-fits-all solution, opportunities exist for banks as clients look for best-practices approaches to ESG investing.

Another area of potential growth is special purpose acquisition companies (SPACs), companies formed specifically to raise capital through an IPO to acquire an existing company. SPACs are not new but are experiencing a revival of sorts, with most holders tending to be retail types of accounts and broker/dealers. This “shiny new toy in the capital markets” presents an opportunity for investors to raise cash.

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**Q: New beneficial owner participants are a great measure of growth - but is there a capacity constraint in securing credit approvals to bring supply online?**

**Marty Tell:** While the industry is working to bring some standardization to the risk process, currently, this is still an idiosyncratic process and would be largely dependent on each firm’s risk groups.

**Q: ESG seems to mean different things to different investors and there is a lack of standardization in measuring ESG compliance - whatever that may mean. Given that the investors aren't there yet, are we in the securities lending industry getting ahead of ourselves in devoting too much thought to ESG outside of Governance (the G) and collateral acceptance/exclusion?**

**Marty Tell:** While the composition of a basket of ESG stocks may change, the capability to receive or pledge customized baskets of securities can be developed in the interim.

## SESSION: ADVANCING DIVERSITY, EQUITY, AND INCLUSION IN THE SECURITIES FINANCE INDUSTRY

**Moderator:** George Rennick, Managing Director-Head of Agency Lending, Americas, J.P. Morgan, and Co-Chair of DEI Conference

**Panelists:** Tamela Woods Merriweather, Senior Vice President and Senior General Counsel, Northern Trust Corporation, and Co-Chair of the RMA Legal, Tax, and Regulatory Subcommittee; Tejash Patel, Managing Director and Global Head of Securities Lending and Fixed Income Client Financing, Morgan Stanley, and Co-Chair of the DEI Conference; Bruce McDougal, Managing Director and Chief Compliance Officer, BlackRock Institutional Trust, and former Co-Chair of the RMA Legal, Tax, and Regulatory Subcommittee

There’s no doubt that promoting diversity, equity, and inclusion (DEI) is the right thing to do, but there is also a business case to be made for a DEI focus. Research has shown that firms with greater diversity and higher levels of inclusion at more senior levels perform better than those that are homogenous. Firms focused on diversity at the senior level also are more likely to have financial returns above their industry peers.



The COVID-19 pandemic has changed the way institutions look at their workplaces and conversely has impacted DEI initiatives. A McKinsey study showed that one in four women are considering downshifting their careers or leaving the workforce due to COVID-19. Although women have made progress, moving into positions at all levels of management, much of that progress was wiped out in a single year, with up to two million women at risk of leaving their jobs. The pandemic has hit women particularly hard, since they tend to have the primary responsibility for child and elder care and are more likely to leave the workforce than men to assume this care.

Senior managers must realize there is a pervasive DEI issue that needs to be solved. Be bold in approaching solutions. Fixing a system that has been wrong for so long will require leaders to make bold decisions. Strive to retain a workforce that is diverse in all ways, particularly with regard to gender and ethnicity. Follow the mantra “no replicates”; that is, don't hire someone who looks like you or has a similar background. If you are doing that, stop, think about it, and start over.

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**Q: Over what period of time does this study span?**

**George Rennick:** Good question. The study was launched in 2015 and covered the period of time from 2015 through 2019, but the study is published annually. The link to the study is available in the reference material on the pdf titled “RMA Branded Reading List.”

**Q: Seems like the need to react to COVID has given you tools to attack the inclusion problem differently. Technology has allowed you to reach more schools, more cities, more people that have left the industry to raise a family. How are you thinking of deploying those tools to aim at this challenge?**

**George Rennick:** Each of us work for firms that have prioritized inclusion, and more specifically intentional inclusion. One example is investing directly into local cities to help develop the local economy and create jobs. I am reminded of how J.P. Morgan invested directly into Detroit, Michigan, to build a city and elevate the opportunities. For all of us there are a number of D,E,&I committees locally, but there is much more to do. The 2020 COVID environment certainly challenged us, but also provided an opportunity to redefine the workplace. The question remains if this will be a temporary change or long term. As business leaders we can take the best of this environment and make those changes permanent. For example, think of an experienced trader who wishes to spend more time at home, or who wishes to relocate. We have proven people can work successfully from a remote location, therefore we can eliminate the antiquated choice of having a successful career or raising a family; instead we can do both, work successfully AND raise a family. Think of all those women who “retired.” I use that term sarcastically, because they “chose” to have a family. This new model is revolutionary and exactly what was missing from the securities lending industry. This new model also creates time, a precious commodity for all of us. For certain individuals we can reduce up to 2-4 hours of commute time per day either a couple of days per week, or on some type of rotational basis by allowing people to maintain a flexible remote working environment. In rare cases we may also be able to support a greater distance between office location and employee. For example, what is to stop one of my team members to work from Florida? Of course, we need to temper that scenario with the need to ensure that culture, cohesiveness, and cross training do not suffer and we still need to adhere to policies and supervision.

“Given the liquidity pressures in spring 2020, the tri-party repo market performed extraordinarily well.”

But if we think boldly, we can make this work. By default we can expand our network and talent pools.

**SESSION: EVOLUTION OF THE TRI-PARTY MARKET**

**Moderator:** Brian Ruane, Chief Executive Officer, Government Securities Services, BNY Mellon

**Panelists:** Robert Goobie, Assistant Vice President, Collateral Management, Fixed Income and Derivatives – Healthcare, Healthcare Ontario Pension Plan; Tracy Hopkins, Executive Vice President and Chief Operating Officer – BNY Mellon Cash Investment Strategies Division; Casey Spezzano, Managing Director and Head of Customer Sales and Trading US, Nat West Markets; Robert Zekraus, Managing Director, Prime Services, Scotiabank; Enrique Verdu, Executive Director, Securities Finance, Banco Santander

Given the liquidity pressures in spring 2020, the tri-party repo market performed extraordinarily well. Despite the flight to quality and strong demand for cash products, there were significant flows into the market during the first two weeks of March. While the Fed did intervene during March 2020, the tri-party reforms and process enhancements enacted a decade ago following the Financial Crisis created resiliency during the pandemic.

In March/April of last year, the sudden move to a work-from-home environment was daunting, with the transition to Zoom auctions and settlements. For the repo market in particular, the ability to make that transition was due mostly to the technology and infrastructure put in place over the last decade. For many, the transition was virtually seamless, given the robustness in volumes and increased activity not just in the U.S. market but internationally as well. The technology in the repo market is still evolving. Although still on the horizon, developments such as digital assets and distributed measure technology may help reduce issues in clearance and settlement, lower transaction costs, and add efficiency to the markets.

Programs initiated by the Fed in March/April 2020 were critical. In fact, there has been discussion about a permanent repo facility, although the market really hasn't been using it since April for term operations and July for overnight operations.

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**Q: Were there significant increases in FICC repo balances during March and beyond?**

**Casey Spezzano:** Yes, the market did see an increase in sponsored repo activity though the peak month of market volatility in March with volumes not reaching those highs again.

**Brian Ruane:** I agree with Casey's comment on sponsored repo. Sponsored repo performed well during the March 2020 period of market volatility and continues to be relatively stable. This supports the view that sponsored repo is an important funding tool for the market going forward.

**Q: Has FIMA repo been a success? Are volumes material and have they been volatile?**

**Brian Ruane:** I would say the FIMA repo has generally been seen as a positive for market stability. I do not have up to date volumes of current usage. It is disclosed in the Federal Reserve weekly release.

**Casey Spezzano:** The FIMA temporary program has been extended to Sept 30, 2021.