US Beneficial Owners Roundtable 2023

During March 2023, Global Investor/ISF held the annual US Beneficial Owners' Roundtable in New York with the help of EquiLend as the lead sponsor. The roundtable was moderated by Global Investor's Managing Director Amelie Labbe-Thomson who was joined by an esteemed group of speakers to discuss recent trends, developments and challenges in the securities finance space.

PARTICIPANTS

Chair: Amélie Labbé, Managing director, News & Insight, Global Investor Group

Brooke Gillman,
Global Head of Client Relationship Management,
eSeclending

John Templeton,
Global Head of Sales and Relationship Management for Securities Finance,
BNY Mellon

Amy A. Dunn,
Executive Director, Americas Head of Relationship Management,
J.P. Morgan

Mike Saunders,
Head of Agency Lending, Americas,
BNP Paribas

Nancy Allen,
Head of Data and Analytics Solutions, **EquiLend**

Francesco Squillacioti,
Senior Managing Director, Global Head of Client Management,
State Street

Cherie Jefferies,
Director of Fixed Income Trading,
State Board of Administration of Florida

Michael Stamm,
Director of Financing & Collateral Management, **State of Wisconsin Investment Board**

Current Market Drivers and Trends

Amélie Labbé: The global securities finance industry has generated an increasing amount of revenue for lenders since 2020, with the Americas region specifically spearheading that growth in multiple areas.

We are gathered here to analyse the situation and see how recent events and potential future developments will impact this situation, which brings me to my first point today looking at current market drivers and challenges.

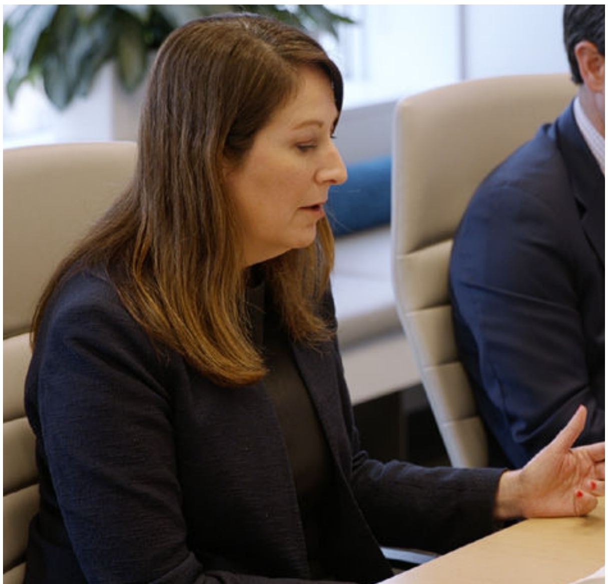
I would like to hand over to Nancy Allen from EquiLend to take us through some key metrics to set the scene for our discussion today.

Nancy Allen, Head of Data and Analytics Solutions, EquiLend: I have a high-level overview here to set the scene for our discussion today. Looking at revenue in 2022, we were up 7% over 2021, with lender to broker revenue of about $9.9 billion.

When you look at that 7% increase, global equities increased by 2%. Overall, global fixed income was up 25% and we'll talk a little bit about the drivers behind that significant increase in fixed income. Looking regionally, the Americas was up 10%. Equities were up 7% in the Americas and fixed income up 19%. In EMEA, we were up 6% with equities and fixed income up 22%. In Asia, primarily dominated by equities, we were down 2%.

Jumping into a couple of highlights into some drivers of revenue. We had seven interest rate hikes in 2022 worth 425bps; that's the highest since 2005, where we had eight interest rates. The rate hikes were key drivers behind the increase in revenue for fixed income.

What we have here is the revenue by quarter and overlaying the revenue we have the average basis points. You can definitely see an increase in the average fee going from Q1 of 2020 - of 31 basis points - up to a high of 39 in Q3. So far in Q1 2023, we're coming in at about $2.2 billion and that's up until March 17th.



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Nancy Allen, Head of Data and Analytics Solutions, EquiLend

Amy Dunn, Executive Director, Americas Head of Relationship Management, J.P. Morgan: In terms of borrower behaviour, counterparties have become acutely focused on RWA and actively targeting RWA friendly client types which are associated with the lowest capital requirements. This has led to providers smart bucketing whereby client types are grouped by their risk weighting which will dictate trade flow. For example, sovereigns and central banks are associated with the lowest RWA and highest demand whereas pensions, insurance companies and '40 Act Funds are associated with the highest RWA and lowest demand. This will clearly have an impact on performance based on what bucket a lender falls into.

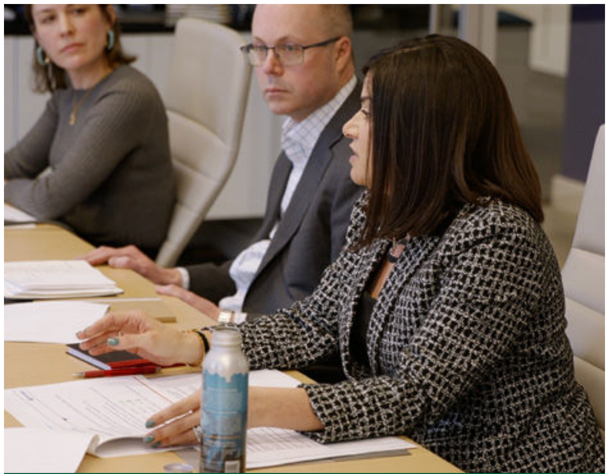
Francesco Squillacioti, Senior Managing Director, Global Head of Client Management, State Street: I think [Amy] hit it right on the head and that's certainly a concern for our counterparties as well as for agent lenders looking at RWA usage: trying to make sure that we're getting out the most efficient high value trades that we can. Certainly, looking at the different types of clients in the program, we're seeing those sorts of patterns turn out in terms of sovereign wealth funds, etc., at a zero risk-weighting, looking a bit more attractive than a 40-Act. So, that's certainly a consideration where you are having discussions with clients – making them aware of RWA impact, both from where we sit as agent lender, as well as where from where our counterparties sit, and showing what those impacts are.

As Nancy points out, it was still a pretty good year. I think our performance echoed a lot of what she presented earlier. The other part is that lender participation has grown, as well. When we think about going forward and bringing new clients onto the program, we're just trying to make sure that the types of assets that we're bringing on are as accretive as they can be to the program as we look at what clients are looking to enrol.

Amélie Labbé: Amy, I'm just going to ask you to share what your thoughts are on what the drivers are going to be that will impact lender and borrower behaviour in the near future, but also if you can give a bit of a flavour as well on types of collateral that we're going to be looking at as well.

Amy Dunn: On the back of Francesco's point, I would agree that client interaction is key. As it relates to the impact of RWA or any headwind facing our industry, in order to remain relevant and competitive, strong consideration of program changes that allow for greater flexibility will be beneficial. We have a limited number of levers at our disposal but the more levers approved, the better positioned a lender is to capture the next revenue opportunity. Common considerations are: collateral flexibility, counterparty or market expansion, conducting a cost/benefit analysis ahead of recalling for proxy, increased participation in trade opportunities and review of cash collateral guidelines.

Cherie Jefferies, Director of Fixed Income Trading, State Board of Administration of Florida: When it comes to borrowers, we depend on our securities lenders to evaluate the borrowers that we use. When we look at the alternative for different collateral between the regulation and the tax harmonisation that's transpired over the past several years, for us, that's always evolving. We're always looking at different types of collateral. Currently we're looking at adding some non-cash



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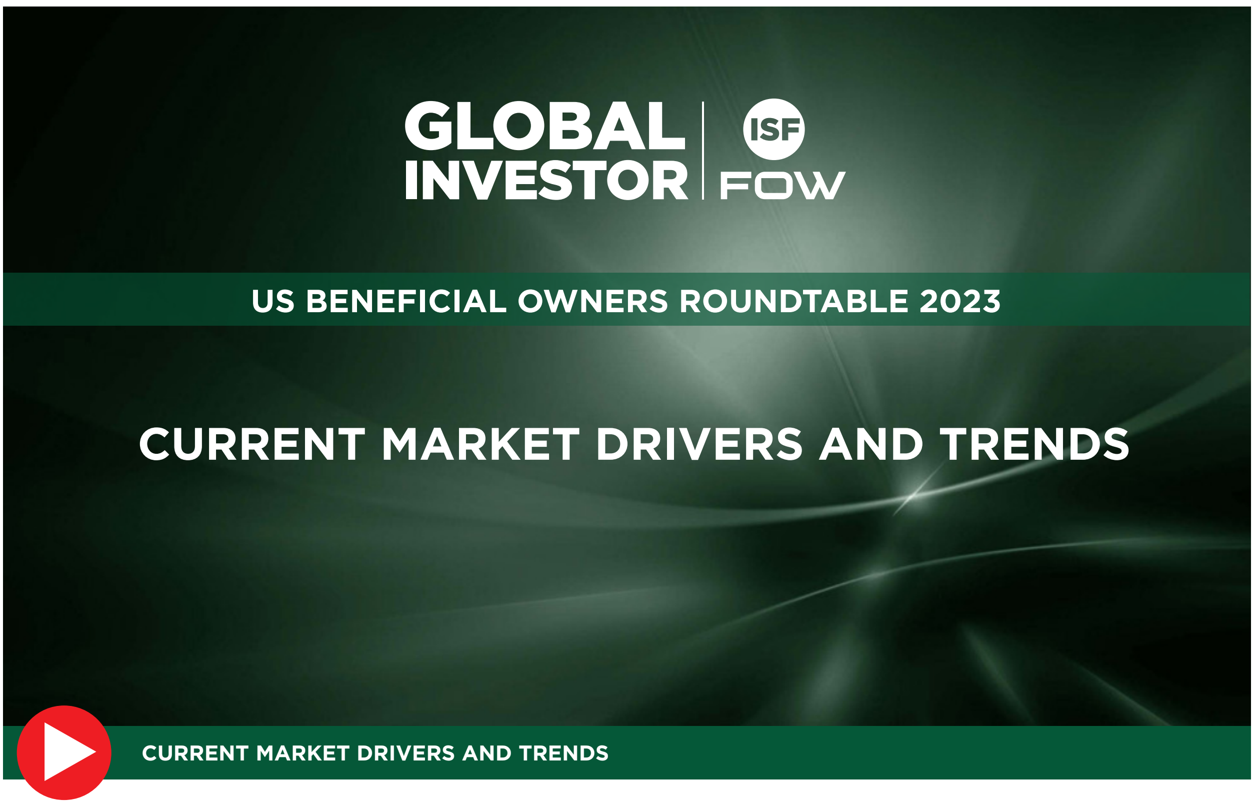

collateral availability to our program.

We're in the process of doing that now, so that has not been finalised, but we always are looking to keep our program abreast of the changing regulations and environment.

Brooke Gillman, Global Head of Client Relationship Management, eSeclending: I think when you talk about flexibility around guidelines, what is starting to transpire now in the industry is not just the things that Cherie and Amy and Cesco were speaking about in terms of collateral types and different sort of transaction components to what the economics are of the trade but it's also about structural flexibility. I think that will be an ongoing theme and so there are a lot of new ways that people are approaching what are the same types of and results in terms of exposure on transactions but done through either a different legal structure or a different mechanism. We have spent time as agent around this table educating the client beneficial owner community on what they can be comfortable with on collateral and things like that.

The next five, ten years will be much more around structural differences of trade types. So whether that may be pledge models or similar models in that sense, central counterparties, agency prime on indemnified programs, there are lots of new structural differences I think that will come into play across the marketplace in order to keep up with the needs that are being driven by these regulatory capital constraints.

Amy Dunn: I would agree. There is an increased focus on identifying ways to leverage the existing pipes and infrastructure in alternative ways. I think there will always be a need for the traditional securities lending model, but as we contend with a smaller universe of specials, rising interest rates, market volatility, evolving UMR and seg IM rules, lenders are faced with new challenges that require different solutions. The industry is beginning to view collateral management, securities lending / financing and liquidity more holistically.

For example, lenders that employ leverage or derivative strategies may be facing new requirements that have forced organizations to think more broadly about how they approach collateral and manage liquidity. Those lenders are not only thinking about these products individually but also how they can be interconnected to optimize overall returns.

Some clients are also exploring alternative ways of utilizing cash collateral. We have worked with certain clients to focus on optimisation and consider opportunities such as leveraging cash collateral raised through a securities lending transaction to finance their needs in a more cost effective way.

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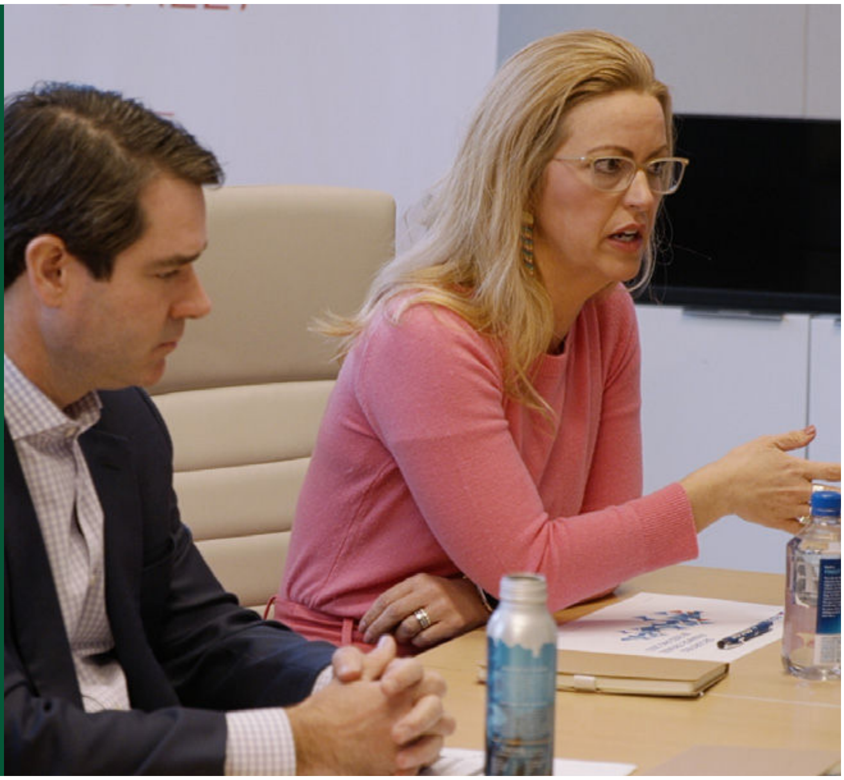
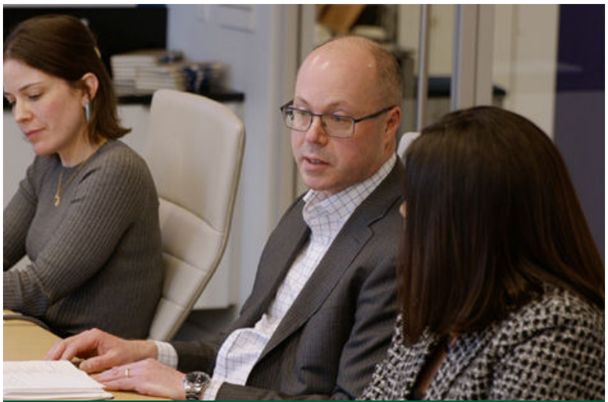


The US regulatory agenda

Amélie Labbé: One topic that some of you touched on is the US regulatory agenda. So can I just turn to John and Amy to give us a very few high-level comments on some of the main regulatory things to look at and that you believe will impact the market or impacting the market currently.

Amy Dunn: The top three regulations that the industry is focused on would be: T+1, which is going to have a significant impact across the US, 10c-1, commonly referred to as US SFTR and Form N-PX which is focused on enhancing the reporting of proxy votes by 40 Act Funds.

John Templeton, Global Head of Sales and Relationship Management for Securities Finance, BNY Mellon: Yes, I would definitely agree on those all being the top three. The other ones that we're focused on are central clearing of U.S. treasuries, the changes to the U.S. capital rules (moving off of standardised RWA and into either revised comprehensive or advanced RWA metrics) and the bilateral repo transparency rules, which is going to require a number of our beneficial owners to start to report those transactions.



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Measuring and tracking costs, risks and performance

Amélie Labbé: One of the big topics that we kind of bring up every roundtable is, measuring, tracking, cost risk performance. My first question for you is what tools do you think are working in the current environment? What data do you look at? Is it of interest to you to measure this performance effectively, but also to keep an eye on competition.

Brooke Gillman: As a lender, you need to know your comparative data set and make sure that it is the right comparative. We are a bit different than the custodial banks or a more traditional agents in that we don't run a pooled program, so every client truly has a different program, and this makes it even more challenging to identify the appropriate peer comparison set.

Today, more clients are using securities lending for different reasons. Many are no longer lending for the sake of lending only. The point is that every program is uniquely different, and you need to appreciate that and apply it when you're looking at the comparative data sets. Otherwise, it's going to be confusing and will lead to the wrong conclusions about performance.

Lenders need to understand why their program may differ from others and know how to assess their own performance. Understanding why you look a particular way within your peer universe is key and knowing what levers can be applied to make a change to performance is important.

The other thing I would say we're seeing is the level of beneficial owner engagement on data is very different today than it was many years ago. If you roll the clock back 25 years in this industry, there was no data available.

That has changed dramatically and now there's very good data from several different sources. It's daily information. You can have data overload quite easily, but how do you use data in an efficient way to make different decisions is what is important.

Mike Stamm, Director of Financing & Collateral Management, State of Wisconsin Investment Board: Brooke, I think you highlight a struggle we certainly have, which is, finding good apples to apples comparisons. We certainly have peer beneficial owners who likely have similar books to us, but they may not view collateral schedules the same, or may not use cash collateral the same way, so their economics become very different.

One thing we try to do through data is to understand the important positions in our book, where do we have an opportunity to really earn some revenue? We focus on that stuff on a ticker level, and beyond that, it is as you have mentioned, we try to find novel ways to utilise that more

commoditised part of our book in a way that can help us differentiate our pool of GC from other similar pools.

John Templeton: I think it's also where the regulations start to align with the data as well. If you think about T+1 settlement coming in and the advent of potentially increasing fails, being able to see what drove fails is going to end up being very helpful.

A key for our clients will be how quickly they're able to provide their sales/recalls to their agent to be able to make sure that their assets are being returned to their custodial account as quickly as possible.

We also see a lot of demand from clients. It's not just whether the data is available, it's how data is available and how to make it easier for them to be able consume it into their systems.

That flexibility to be able to set up reports in multiple different ways, whether it's a report, or it's a data extract, or an API that's going system to system to a client. There are a number of clients who are looking for that type of data to be able to analyse it faster than they did before.

Evaluating the impact of tech

Amélie Labbé: Looking specifically at how and where innovation is coming from, where it's going as well and where you see investment going into, in terms of tech

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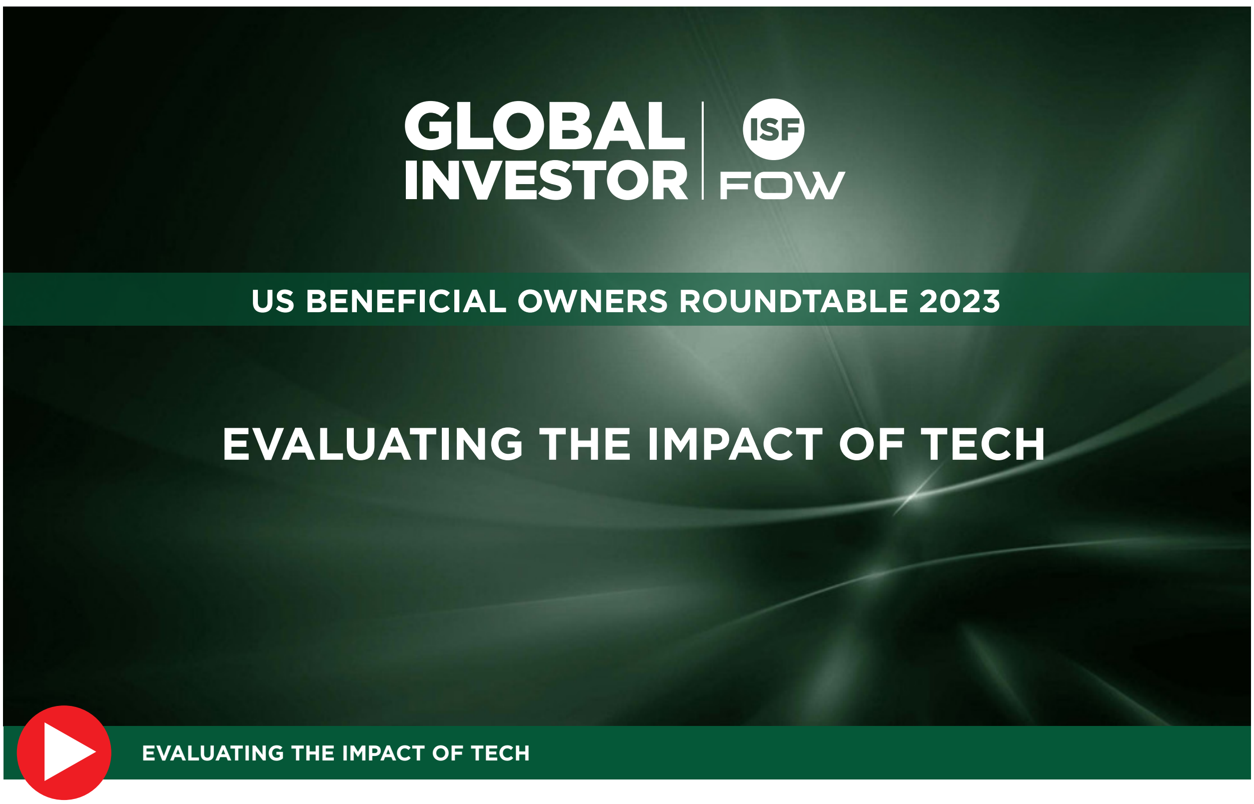
and any sort of comments you have around that. Michael Saunders - I know that you actually have some very interesting thoughts that you shared last year on this topic, so I'm keen to hear some key issues this year as well.

Mike Saunders, Head of Agency Lending, Americas, BNP Paribas: Securities finance is a maturing business. While the lender base has grown, the number of participants has grown, but the number of personnel has shrunk. For the most part, that's through the efficiency of technology.

Aside from analytics there are vendors out there that will help you with onboarding, with liquidity discovery, with proxy identification, with collateral management, with efficient use of capital and collateral optimisation not to mention ESG analytics. And the list goes on.



Most of the information that we're developing internally is really just pulling all of our vendor services together to make it operationally easy whether it's a trading or risk management perspective, client web reporting, all of that, just to make that run more efficiently.

I think a lot of the technology in the fintechs that are out there allows you to do that. So, I only see that becoming a greater and greater portion of our overall business and activity.

Francesco Squillacioti: To the point made about efficiency, that's really the name of the game. We need to get the best assets out at the best rate that we can, the most efficient way possible and we can't do it really without reliance on data and analytics.

We've also got a team that – our Algorithmic Trading group - is dedicated to pricing, and they're constantly looking at pricing across the market, across what we're doing, looking at trends within our own book and just making sure that we're trying to capture any possible move that we can in pricing and then on the client side. So, certainly, a lot of time and investment is spent in that type of technology for us.

Cherie Jefferies: We have a data provider that we use and we have worked with them in our sec lenders or with the information on the provider with our sec lenders to get certain securities out or look how a security is going to be loaned out before we purchase.

We don't do it too often but we have done that in the past and when it comes to the data that was provided by our sec lenders, what we found several years ago is, we had different departments pulling different data from our sec lenders and we have created a program that accumulates all this data so everyone has access to the same information and everyone's pulling the same information, so the beneficial owner, we're all looking at the same ratios, we're all looking at the same levels, revenues. We're all making the same decisions off the same information, so we've been working on that for several years and almost completed and so we're excited about that.

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Nancy Allen: On the technology front, as a fintech, we continue to focus on connectivity and bringing efficiencies to the market.

On the innovation front, I would highlight a big initiative that we're working on, which is called OneSource, which is designed to be a single source of truth in the securities lending market for lifecycle events and the aim there is to eliminate reconciliation issues. It will be a game changer. We do have a number of the organisations who have already committed to working with us on developing OneSource. A lot of the issues in lending happened after you put that trade on and OneSource will help address those issues and streamline it to be more efficient for everybody, including the beneficial owners.

Portfolio management, where next?

Amélie Labbé: Brooke, I'm keen to get your thoughts on where demand is coming from for the beneficial owners and how it's impacting liquidity and if you could maybe give us some comments as well on revenue opportunities that potentially exist as well for beneficial owners when it comes to alternative forms of collateral, for example?

Brooke Gillman: I think that the biggest trend is the approach that beneficial owners are taking globally is very different than it was a few years ago. Beneficial owners are looking at it more as one of their investment tools.

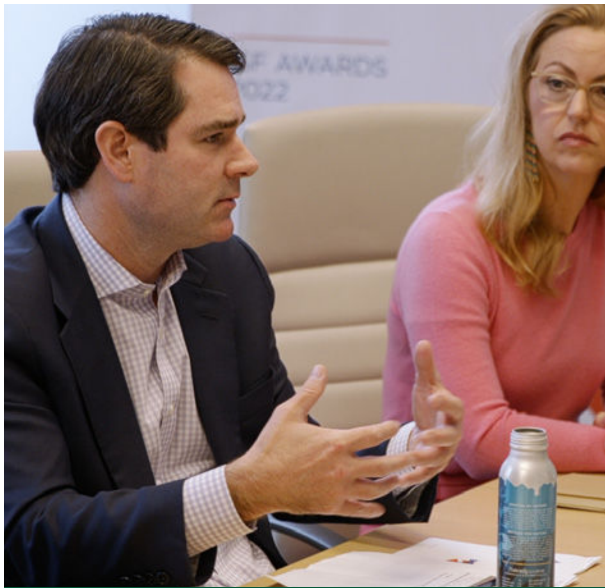
Depending upon what their goals are they'll use security lending or repo differently. We still see traditional securities lending programs and activities, but we're also starting to see securities finance used more as a broad financing tool. Asset owners are looking at securities financing from a big picture perspective. We are seeing a lot of collateral transactions and a lot of collateral funding trades.

It's all about using securities finance as a tool in the portfolio management decision making process. As more asset owners adopt this approach, we will continue to see growth in our industry. They will also continue to evolve how they look at their programs and therefore providers will adapt and offer new solutions and services in order to try to keep up.

Mike Stamm: Brooke you made a point about a holistic view of sec finance, and that is something we think about a lot. What is the best fit for our assets to meet our needs for liquidity, revenue, collateral, and safety. And that fit may include swap, futures, repo, and sec lending. What we look for is opportunities to reduce bad carry trades, if we are borrowing cash to reinvest in a lower yielding finance structure, we should examine that. And it can be more difficult than you expect to identify those implicit carry trades. I find it a very interesting puzzle to fit together.

Amy Dunn: To Brooke's point around broadening the conversations to include more than just traditional securities lending, the ability for an organization to provide this suite of services under one umbrella will be a differentiating factor when selecting a provider especially as the industry continues to evolve.

Mike Saunders: So it's this concept, at least the one we see, of the securities lending activity becoming central to the funding needs throughout an organisation. Securities lending is one tool for liquidity management, the kind of cheapest form of collateral. We see this as part of the reason for the increased utilisation of corporate bonds in the market. Yes, of course, a lot of that is interest rate driven but I can tell you that a fair amount of beneficial owners have been in the market lending their portfolios just to raise cash that they're using for other purposes. So, it's this whole concept and I think, Brooke, you touched on it before, that securities lending cash is cheaper than credit facilities, revolvers and things of that nature. The general premise is, I see these walls breaking down and securities lending is now securities finance. ■



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