ISLA

Securities Lending Market Report

>>> An ISLA Publication | 15th Edition | June 2021

Securities Lending Market Report

June 2021

>>> Index

Foreword

>>> Welcome to the 15th edition of ISLA's Securities Lending Market Report.

Andrew Dyson, CEO, ISLA

Much has been said and written about how we are living in unprecedented times with the COVID-19 pandemic touching almost every aspect of our personal and professional lives. As we look back to final weeks of 2020, governments and health authorities, especially in richer developed societies were looking increasingly towards vaccines to lead them out of the pandemic.

Whilst the reality has been somewhat different with the so-called Delta variant disrupting plans to ease restrictions across the world, we are seeing better treatments and vaccines beginning to suppress the wider impact of COVID-19. Set against a backdrop of the realisation that COVID-19 will be something of a permanent feature of our lives for the foreseeable future it is interesting to see how investors and markets have become accepting of this new norm. In early 2020 we saw periods of extreme market volatility as the world came to terms with the pandemic, at one point in mid-March the CBOE Market Volatility Index (VIX) touched 85. However, and notwithstanding what was happening with the pandemic since, markets have been much more benign with the VIX trading between 15 and 27 in the past three months. Similarly, stock markets have returned to a form of normality with the benchmark S&P 500 making gains of over 14% in the first six months of the year.

After some of the most turbulent years in British politics the UK finally left the influence of the EU with the end of the Brexit transition period on 31st December 2020. Most notably the final Brexit trade deal made almost no provision for financial services. As an association that now has a broad membership in both the UK and the EU27 we follow developments here with keen interest. Although we sense that many of our members have already moved to a business model across Europe more broadly that reflects this position, it is frankly disappointing to hear Bank of England Governor Andrew Bailey say at a recent news conference that nothing has really moved forward on equivalences in the past six months. Our markets have a strong history of innovation and may have already discounted any further progress in this area, but I would highlight the importance of getting the balance right between promoting your own ideals and political priorities with those of operating a safe and efficient marketplace that accurately reflects the societies that they serve.

Fig 1 - ISLA

Turning momentarily to our markets, in the first half of 2021 profitability seems to be returning. According to recent reports from DataLend global securities lending activity during the first six months of 2021 contributed €3.8 billion in revenue for lenders. This represents a 17% rise year-on-year from the €3.3 billion in revenue generated in the first half of 2020. This is of course very encouraging to see and reflects how our markets are adapting to the needs of borrowers particularly across fixed income markets and in areas such as IPO's and special-purpose acquisition companies (SPAC's).

> One of the most important roles that an association plays is to try and understand what market trends are telling us about the future and then work with our membership on developing mutualised solutions or outcomes that pursue our core objectives of promoting open and transparent markets.

That adaptability will be important as we think about the remainder of this year and in to 2022. We have already seen how SFTR has transformed how we think about elements of our markets in Europe, and it was to an extent a precursor for the start of our digital work in the form of the Common Domain Model (CDM). The market will be tested again with the imminent implementation of CSDR and the impacts of fines for failed trades supported by a mandatory buy-in regime will change the face of post trade settlements. At the time of writing, we are still waiting for the outcome of discussions within the regulatory community as to how to take elements of CSDR forward, but in recognition of the importance of this issue to the smooth running of our markets, we will continue to work with our members to deliver best practice outcomes over the coming months.

One of the most important roles that an association plays is to try and understand what market trends are telling us about the future and then work with our membership on developing mutualised solutions or outcomes that pursue our core objectives of promoting open and transparent markets. Recently two issues have begun to dominate that forward looking agenda. I have already mentioned our work on the CDM and this together with our concurrent work to develop a standardized taxonomy for our suite of master agreements in the form of a Clause Library provide the digital building blocks that will underpin the market in the future. This work is gaining significant momentum and is already resonating across our industry and beyond as market participants and wider stakeholders including the regulatory community see the potential that digital standards will deliver over time.

The second is the topic of sustainability which is fundamentally changing the way we think about the investment process and what we as investors now want from our investment portfolios. As issues such as active shareholder engagement and voting come to the fore there are important implications and challenges for our markets to ensure that securities lending can both align and co-exist alongside ESG portfolios. As we see more from regulators and policy makers it will be important that ISLA continues to advocate strongly for the pivotal role that our markets play in providing market liquidity and allowing alternative investment managers amongst others to adopt short positions as part of a broader capital markets eco system.

In closing, I would like to highlight some changes to this latest edition of the Securities Lending Market Report. For the first time I am delighted to announce that we have invited guest editors from the industry to provide the summary of securities lending trends from the first half of 2021.

For this, I would like to thank Matthew Neville, Head of Agency Lending Trading, EMEA and the global trading team from State Street for providing market commentaries for the global fixed income and equities markets. You will also find the addition of a new section, edited by Lewis Nicholson of ISLA's Regulatory and Market Practice team, and host of the SFTR Working Group, where we review the publicly available SFTR data sets and what this data is showing us about our markets.

Finally, but by no means least, I would like to thank our data partners: Triparty agents BNY Mellon, Euroclear, Clearstream and JP Morgan, and market data firms DataLend, IHS Markit and FIS Global for providing the underlying data without which it would not be possible to produce this report. **AD**

Global Trends

Securities On-Loan

€2.3Tn Dec 20 €2.6Tn Jun 21

Includes Corporate Bonds

Lendable Assets

€24Tn Dec 20 €28Tn Jun 21

The S&P gained 14% over the same period

Revenues

€3.3Bn Jun 20 €3.8Bn Jun 21

Reported revenues up 16% compared to the same period in 2020

Market Volatility (VIX)

23 Dec 20 16 Jun 21

Low market volatility as COVID-19 vaccinations roll out around the world and reduce market fears

S&P 500 Index

3756 Dec 20 4297.5 Jun 21

Global Securities On-Loan by Fund Type

Government Bond Markets

Utilisation

35% Dec 20 34% Jun 21

Securities On-Loan

€1.1Tn Dec 20 €1.2Tn Jun 21

Balances remain historically high

Collateral

Corporate Bonds Held in European Tri-Party

10% Dec 20 10% Jun 21

Asian Government Bonds Held in European Tri-Party

33% Dec 20 31% Jun 21

Global Equities Held in European Tri-Party

44% Dec 20 45% Jun 21

Equity Markets

Securities On-Loan

€984Bn Dec 20 €981Bn Jun 21

Lendable Assets

€14.1Tn Dec 20 €17Tn Jun 21

Increase of 17%

Providers

DATALEND
IHS Markit
FIS
J.P.Morgan
BNY MELLON
clearstream
euroclear

Securities Lending Biannual Market Review, H1 2021

Matthew Neville

Introduction

Looking back on the first half of 2021 and the various challenges exacerbated by the pandemic, we can be very proud of the way the securities finance industry continued to collaborate and execute on solutions to solve our binding constraints, ultimately delivering the best possible outcomes for our clients.

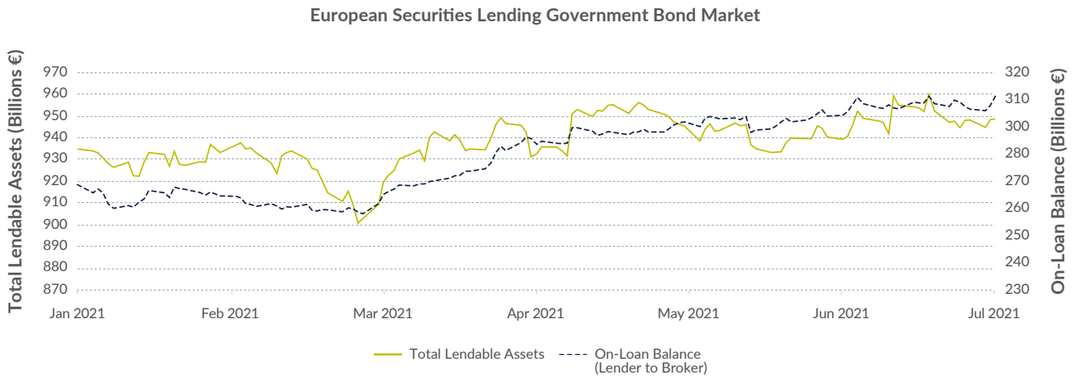
I am encouraged that many of us are now meeting again in person, and despite some anticipated stutters in return to office over the coming months, I am certain we are all looking forward to the additional buzz and creativity that can only come from more in person collaborations.

Let's take a look at how the markets performed during the first half of the year from a State Street perspective.

Fixed Income

>>> Europe

Fig 2 - DataLend



Central bank intervention has restricted the ability for the fixed income desks to generate spreads achieved in previous years. Effectively, the European Central Bank's (ECB) Pandemic Emergency Purchase Programmes (PEPP) collapsed spreads between core euro government bonds and the periphery. Therefore, although we saw some bonds trading with value, for example, around cheapest to deliver dates, the majority of fixed income loans have traded at GC levels.

The USD JPY basis trade, historically, a good source of revenue as spreads widen over year and quarter ends as well as the three-day Japanese holiday in May, did not materialise, as spreads remained benign due to excess liquidity in the system.

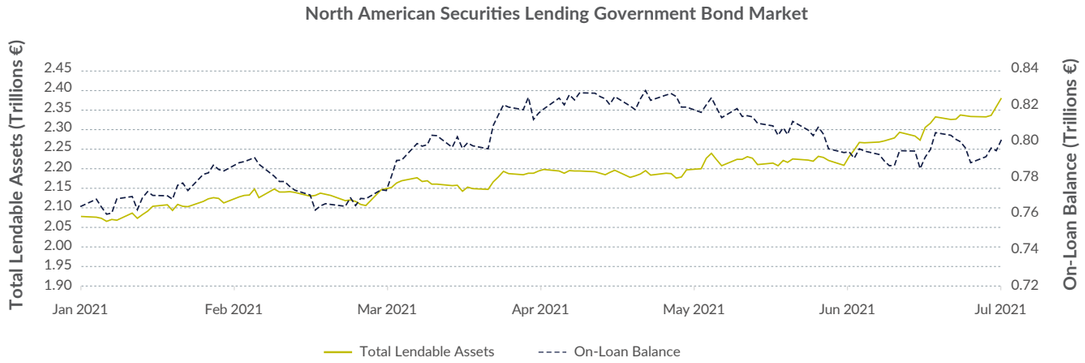
Similarly, there was a general reduction of corporate bonds requiring funding by the street due to the effects of central bank quantitative easing.

On a positive note, we have seen more borrowers shift demand for corporate short covering into the automated space using third party vendor platforms. We have also seen a shift in collateral balances from cash to non-cash, partly because of the lack of cash reinvestment returns available whilst the yield curve remains flat. Broadening our collateral eligibility to include additional countries of risk in the emerging markets, as well as adding automation versus JGB and equity collateral has added further appeal and take up by borrowers.

Despite the challenges around spreads, demand for high quality liquid assets (HQLA) and corporates has remained strong, and balances are outperforming previous years.

>>> US

Fig 3 - IHS Markit



The theme for the first half of 2021 was the continuation of global central banks providing unprecedented easy monetary policy to markets outside of war efforts. In the US, the Federal Reserve dropped interest rates to zero in March 2020 and began yet another quantitative easing programme for US$120 billion per month in order to ensure confidence and liquidity. The US Federal Reserve crossed red lines to purchase assets, including corporates and municipals, outside their given mandate to signal that any necessary action would be taken to prevent economic disaster from COVID-19.

Easy monetary policy was met with equally easy fiscal policy - putting liquidity directly into the bank accounts of citizens. Cash and equivalents increased by orders of magnitude again not seen outside of a war effort. This liquidity was raised and maintained by issuing T-Bills and cash in the Treasury's General Account distributed through fiscal channels as new programmes were approved by the US Congress. These actions have proven beneficial to risk assets and employment has improved. Nonfarm payroll numbers increased significantly every month with a slight hiccup in April when economists were expecting over one million jobs gained but only printed 266 thousand. Inflation risk was inevitable and appeared in earnest when the April consumer price index jumped 0.90% month over month, a number not seen since the early 1980s.

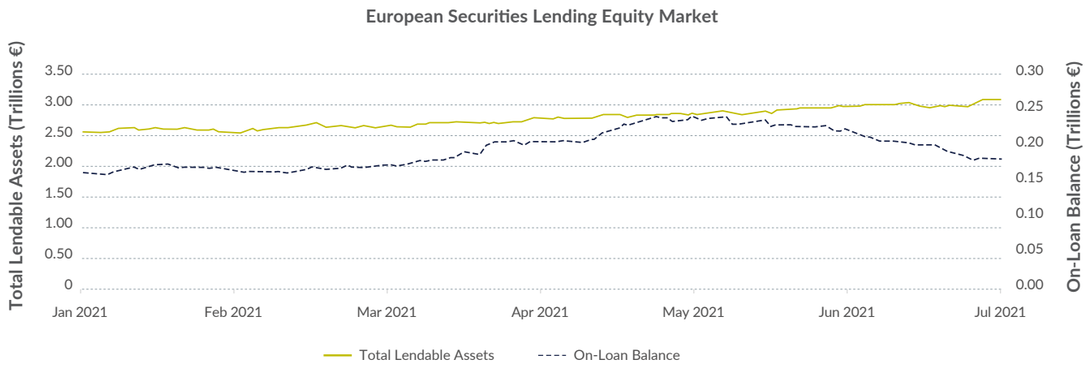
Cash market yields rose violently at the start of 2021 and continued throughout the quarter as vaccine distribution improved and states began to reopen. The 10-year note yield peaked at 1.74% at the end of March rising from 0.90% in January. The belly of the curve rose in lockstep - the five-year note markedly peaking at 0.94% from 0.35% at the start of the year. This period was very strong for US Treasury shorts across the yield curve despite the increased coupon issuance. The long end began its current rally at the end of May as the COVID-19 Delta variant made headlines and accelerated when the price action became the story.

GC began grinding toward zero percent in February, where it remained until the Federal Reserve hiked both the interest rate on excess reserves (IOER) and the reverse repurchase (RRP) facility at the June Federal Open Market Committee (FOMC). As reserves rose to the highs, demand for positive yielding assets was greater than supply, which forced cash into the Federal Reverse Repo facility at a zero percent rate. GC responded immediately and moved away from zero. When the Treasury General Account decreased as fiscal stimulus was distributed, RRP usage increased in kind and reached a peak just under US$1 trillion on 30 June 2021. RRP usage is expected to remain elevated as the US Congress debates the debt ceiling limit set to expire on 31 July 2021.

Equities

>>> Europe

Fig 4 - IHS Markit



EMEA equity lending saw mixed performance over the first half of 2021.

GC balances were up 48% year over year (YoY) and, in absolute terms, are the highest we have seen in at least three years. However, warms and specials as a percentage of the loan book were down significantly as corporate activity remained mooted and exposure to companies hit hardest by COVID-19, such as the retail, travel and entertainment sectors, were reduced as vaccination programmes were rolled out globally.

Despite the lack of activity, when companies did come to market to raise capital, there were good revenue opportunities for clients, such as the deeply discounted rights issue by TUI (TUI LN and TUI GR) and from the lapsed rights of Euronext (ENX FP) and Credit Suisse (CSGN SW).

EMEA was not immune to the battle between retail investors and the short sellers. The fallout from the Reddit-led short squeeze in GameStop (GME US) in the US spilled into Europe, with hedge funds closing their shorts in positions with high short-interest, notably CD Projekt (CDR PW) and Varta (VAR1 GR), both strong revenue earners at the time.

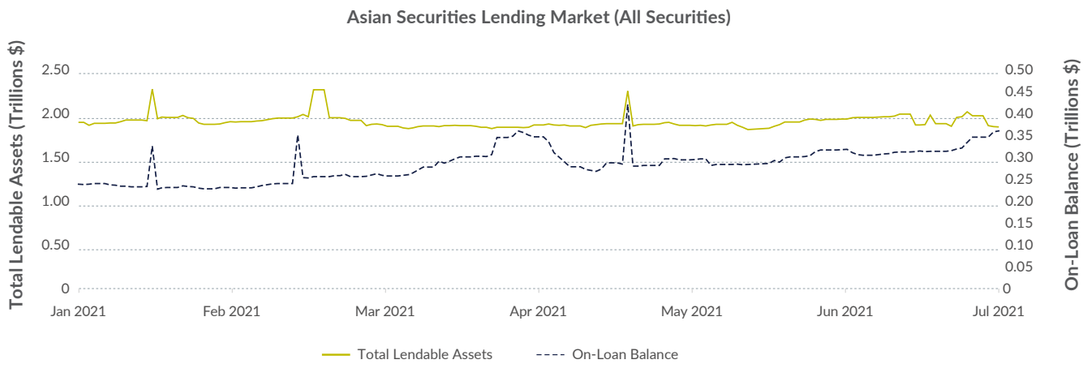
Seasonal demand for record date securities was markedly up this year compared to 2020 as companies resumed and increased dividend pay-outs. Scrip dividend values are up YoY but still down over 50% since 2019. That said, the spread between the cash and stock elections on UK REIT Hammerson in April created one of the largest revenue opportunities of the year so far.

Continued tax harmonisation in Europe led to reduced low-dividend supply in some markets, particularly France and Italy, where more beneficial owners are now able to receive their dividends free of withholding tax.

Additionally, rules implemented by tax authorities in Denmark and Austria have led to rejections of tax reclaims by clients on securities returned by borrowers on or after AGM (Denmark) or after Ex Date-1 (Austria), resulting in lenders either restricting returns around key dates or restricting supply to avoid the risk of rejection altogether.

>>> Asia Pacific

Fig 5 - FIS



US-led sanctions on Chinese companies made for a challenging start to the year in APAC. A handful of affected liquid Hong Kong listed companies quickly turned special whilst demand for Hang Seng Index (e.g. 2800 HK) and China A share ETFs (e.g. 3188 HK) fell out of scope for many institutions, ending their long run as broad-based hedging tools for China. The Hong Kong IPO pipeline remains strong and the abrupt cancellation of ANT Group's IPO sent ripples through the market creating further short selling opportunities.

Access to China continues to stir considerable interest. China relaxed their Qualified Foreign Investor (QFI) eligibility requirements in late 2020, enabling more participants to engage in stock lending. However, market infrastructure limitations remain as significant hurdles to physical lending in QFI and Stock Connect for Agent Lenders. Furthermore, whilst the Asia Securities Industry and Financial Markets Association (ASIFMA) seeks clarification on the uptick rule from the China Securities Regulatory Commission (CSRC) and local exchanges, many have pushed the pause button on their China Securities Borrow Loan (SBL) ambitions, with swaps likely remaining the significant means of market access for short hedging by foreign funds.

On the long side, China Connect A share collateral continues to interest market participants as they seek to unlock trapped assets.

Demand in Korea sparked back to life in May after the regulators lifted a ban on short selling that lasted 14 months. Regulators agreed to resume activities by enhancing fails penalties, committing to improving securities borrowing and lending (SBL) access and short selling for retail investors and by narrowing down the list of eligible short sell securities to the Kospi 200 and Kospi 150 indices. Despite these changes and ongoing challenges, the appetite to hedge has rebounded and utilisation levels appear close to pre-pandemic levels. Borrower demand to provide Korean Equity and Korean Treasury Bonds as collateral also remains healthy.

>>> Asia Pacific continued

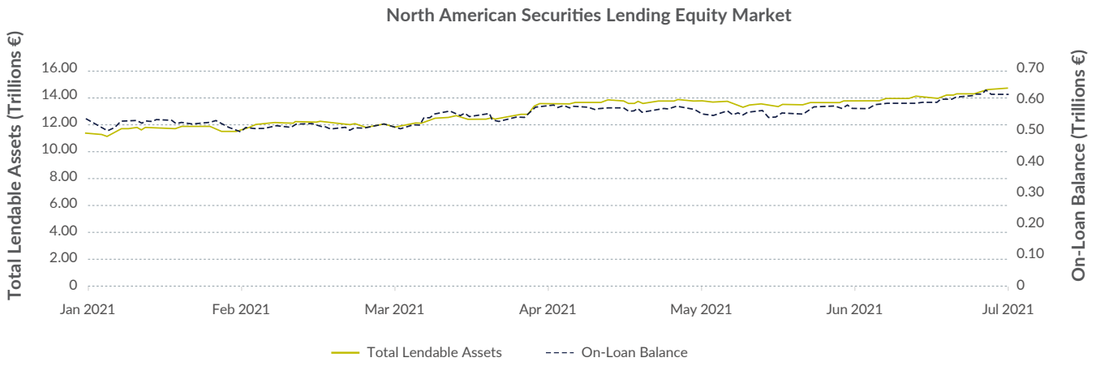
Turning to Japan, corporates have been resilient in their ability to pay dividends and street demand remained strong in March. Seasonality aside, borrow has been generally subdued with limited specials and GC pricing remains low due to an abundance of available liquidity. Interest to provide Japanese yen (JPY) cash collateral has softened as cross-currency basis spreads thinned and Japanese government bond (JGB) collateral offered lower spreads throughout the first half of the year.

Taiwan has been a standout performer so far in 2021, with the shipping and semiconductor sectors particularly in high demand. SBL fee lending caps reduced from 20% annualised to 16% annualised following a change to the country's money lending laws. Thailand's pandemic lockdowns have affected tourism and the local economy significantly, driving further interest in borrow demand across a multitude of sectors.

Malaysia, Singapore and Australia remained somewhat subdued with no standout events during the first half of the year.

>>> US

Fig 6 - IHS Markit



New issues proved to be one of the main revenue drivers during the first half of the year, either through pre and post-merger special purpose acquisition vehicles (SPACs), direct listings or traditional initial public offerings (IPOs). Many generated significant lending revenues and dominated the highest earner tables for the second quarter.

As SPACs provide speculation on both the long and the short side, demand from borrowers has been for lenders to provide liquidity for short sellers, as well as to provide financing on the longs, either through traditional equity indices or through bespoke risk-managed collateral buckets.

Altimeter Growth Corp (AGC) and Churchill Capital IV (CCIV) are two examples of SPACs in high demand that are yet to complete mergers and are being targeted by the shorts.

Another theme from the first half of the year was the meteoric rise of the retail investor.

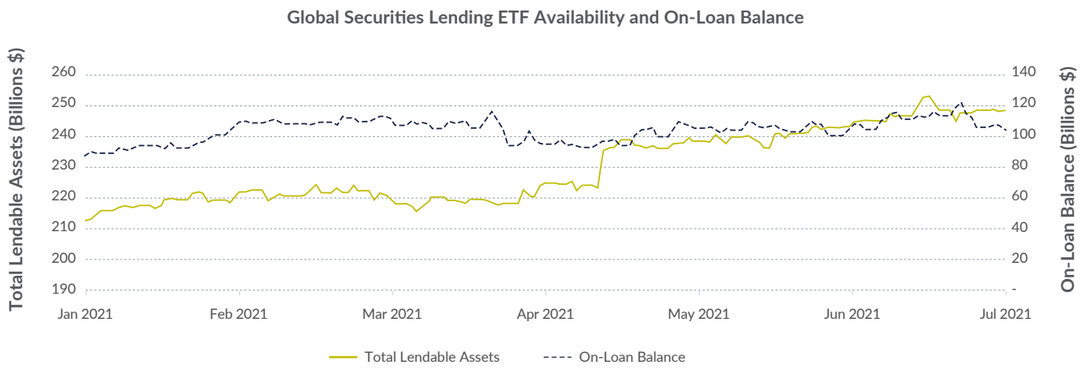
Little did we know that the global monetary efforts over the past year (interest rate cuts, easing of policy and stimulus payments) would create an opportunity for Main Street to take on Wall Street as crowds of retail investors, encouraged by Reddit and other social media boards, armed themselves with Robinhood trading accounts and purchased downtrodden names like Gamestop (GME), AMC Entertainment (AMC) and Hertz (HTZZ) in huge numbers in a direct battle against the short sellers. As we now know, GME saw one of the largest short squeezes in history and the margin calls that followed led to significant deleveraging. As funds moved into risk-off mode, record long sales and short covering drove a reduction in loan balances and compression of spreads in the specials space as a whole.

Although the lack of specials persisted until May, general collateral (GC) and warm demand remained buoyant throughout the first half of the year, partly as a result of borrowers having less inventory to internalise post the sell offs.

We finished the second quarter with a reminder of how the first quarter started, as retail forced another short squeeze, this time in AMC, a top revenue generator as the price was forced from USD 12 to USD 62 in a matter of days.

Exchange traded fund (ETF) demand certainly increased post the February volatility as borrowers turned to broader market hedging instruments in the equity space. Borrows in SPDR SP500 (SPY) and iShares Emerging Markets (EEM) remained steady, most likely as a portfolio hedge. Whilst relatively easy to source in the latter half of 2020, high yield exposure returned with strong demand for both iShares iBoxx H/Y (HYG) and the SPDR Barclays H/Y (JNK) as stability in overall supply proved to be volatile.

Fig 7 - FIS

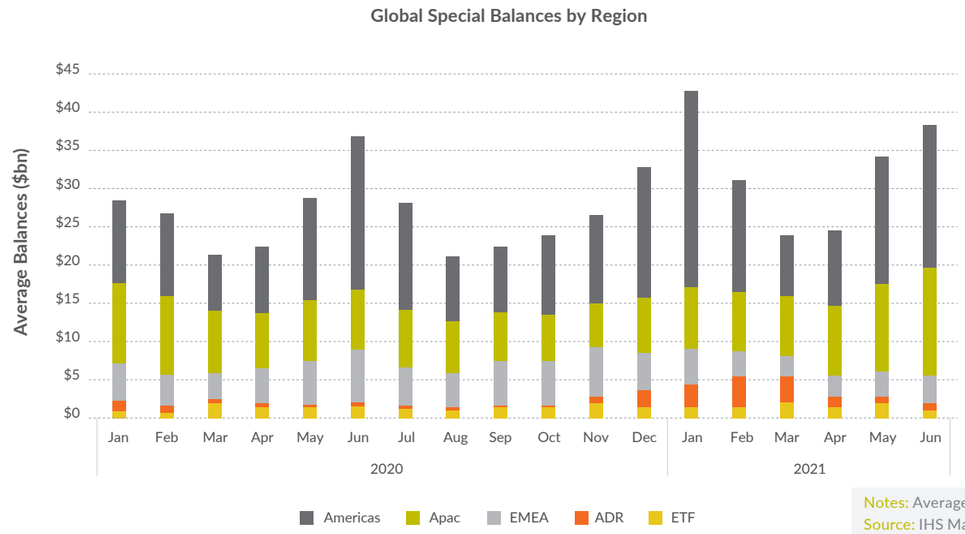


Looking at sector specific demand, securities linked to clean energy and electric vehicles, across distribution, batteries and charging were some of the most sought after by borrowers. We saw strong demand for QuantumScape (QS), Blink Charging (BLNK), Arrival Group (ARVL), Canoo (GOEV), Luminar Tech (LAZR) and Chargepoint Holdings (CHPT).

Fintech also made up a significant slice of the first half year revenue - Sofi Technologies (SOFI), Rocket Companies (RKT), Upstart Holdings (UPST) and Futu Holdings (FUTU) were all amongst the top revenue generators, as they push to disrupt the traditional financial services model.

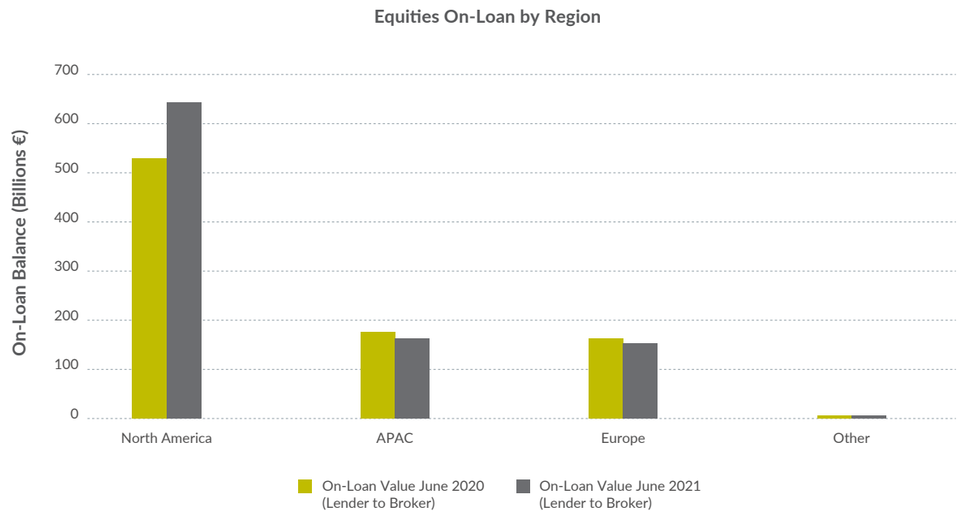
GC flow continues to be the main driver of demand in Canada. Overall balances have returned to pre-COVID-19 levels, however, specials activity on the whole remains quiet.

Fig 8 - IHS Markit



Notes: Average balances with fee > 500bps
Source: IHS Markit Securities Finance

Fig 9 - DataLend



Final Thoughts and Looking Ahead

The first half of 2021 has been volatile on many fronts across all asset classes. Balances have been at recent record highs and whilst spreads have had multiple peaks and troughs across equities, they have remained thin on fixed income. Until the central banks step away from propping up the system with liquidity or raise interest rates, this is likely to continue.

We have much work to do during the rest of the year.

Borrowers and lenders alike are grappling with their own financial resource constraints, which change continuously. The ability of agents to make securities available to borrowers through multiple methods will be a key enabler to assist the management of those resources. We are seeing increased demand for Global Master Securities Lending Agreement (GMSLA) Security Interest (Pledge) provision across all triparty providers and a requirement to view clients from a risk weighted assets (RWA) perspective. A client's ability to accept broad ranged collateral, term transactions and Pledge as well as their RWA appraisal will all continue to be key factors driving utilisation and performance.

From a regulatory perspective, the industry is working with the International Securities Lending Association (ISLA) to determine the impacts of the Central Securities Depositories Regulation (CSDR), where there is a rush to minimise fails and the potential penalties that may ensue with the help of functionality and visibility from the post trade services platforms.

Environmental, social and governance (ESG) is also at the heart of client conversations, and we welcome the work that is taking place at ISLA in encouraging conversations with member firms to think about a framework for solutions in this space.

Digitisation and tokenisation have hit the agenda on the back of the crypto wave this year, although we expect this to be a huge lift for the industry, the benefits of reduced settlement timeframes for loans and collateral will completely transform our industry in terms of efficiencies, removing the need for markets to be open during limited hours as they are today. We expect this topic to be on the agenda for many years to come.

Finally, thank you to all our clients and counterparts, service providers and to ISLA for your continued business, support and engagement to date. We look forward to continuing to collaborate with you throughout the rest of the year and beyond.

Matthew Neville is a Managing Director and Head of Agency Lending Trading, EMEA, for State Street Global Markets.

Exploring SFTR Data

Introduction

Following the first anniversary of the belated go-live of Securities Financing Transactions Regulation (SFTR), it is interesting to study the new data we have available to us through the TR public data. This data is released weekly by the Trade Repositories, who are responsible for collecting and maintaining records of SFTs from participants under SFTR and is a representation of all reported positions from that week.

This data allows us to paint a picture of the state of securities lending markets, in the context of what has been reported under SFTR. Although there is work to do to improve the accuracy of this data, particularly around volumes, we can still discover and measure some noteworthy trends.

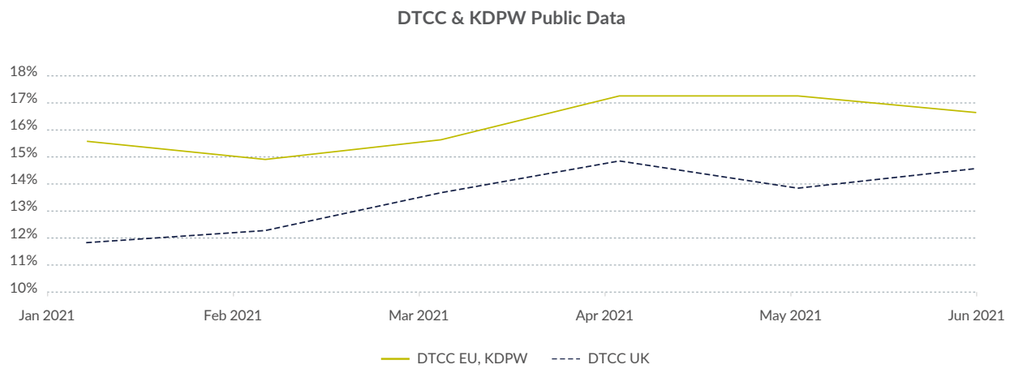
ISLA has been working on the capacity to aggregate and measure the weekly TR public data file from three of the registered trade repositories (DTCC, Regis-TR, KPDW), including the separate UK data from those registered in the UK (DTCC). Along with data gathered from other sources, in this section we will discuss some of the trends we are noticing within the data surrounding SFTR. With the withdrawal of UnaVista as an SFTR trade repository in January 2022, UnaVista public data has not been included.

>>> The use of pledge in securities lending is increasing

The volume of collateral reported under pledge agreements appears to be increasing. Looking at data provided by DTCC for June 2021 we see 16.06% for EU and 14.39% for UK total reported collateral as under a pledge agreement, compared to 15.20% and 12.14% for January 2021 respectively. These figures are broadly in line with data from triparty agents.

As the usage of the GMSLA pledge agreement increases, we should see these percentages increase as those contract changes filter through the SFTR reporting.

Fig 10 - DTCC Public Data



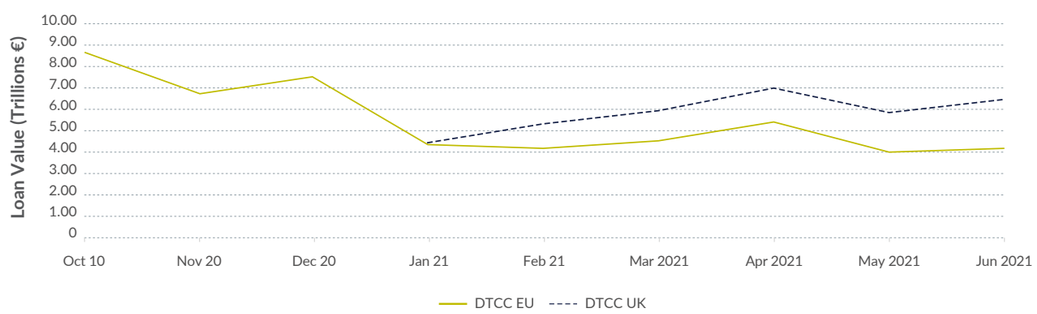
Due to data anomalies within the reported collateral value, Regis-TR data has not been included in this graph. As data quality improves, we hope to include these datasets in later reports.

>>> EU to UK volume shift post Brexit

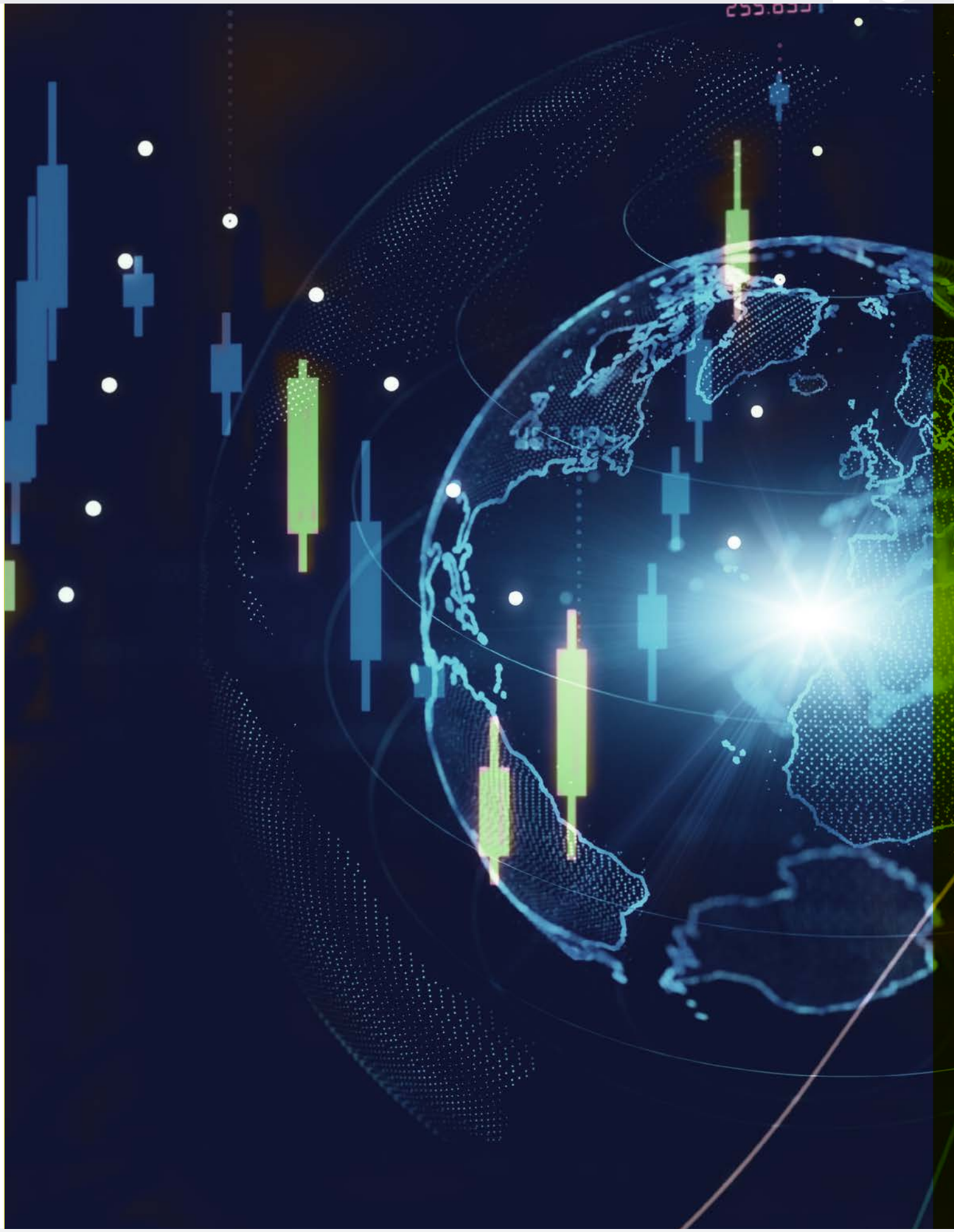
At the end of the Brexit transition period, we saw a shift of reported loan volumes as SFTR was bifurcated into two regimes covering UK and EU. If we compare Q4 2020 – Q2 2021 data from DTCC's European trade repository and its UK equivalent, we observe a €3.1 trillion drop in reported loan volumes from December to January, with DTCC UK reporting €4.4 trillion in its first month of public data. It is interesting to note that the reported volumes at the UK repository have been consistently higher in the first 6 months of 2021.

Notably we are currently seeing a trend of on-loan values increasing more quickly within the UK when compared to the EU, although it is perhaps too early to know if this trend will be maintained.

Fig 11 - DTCC Public Data



We have focussed on DTCC for this metric as the only TR operating under both EU SFTR and UK SFTR following UnaVista's withdrawal in January 2022.



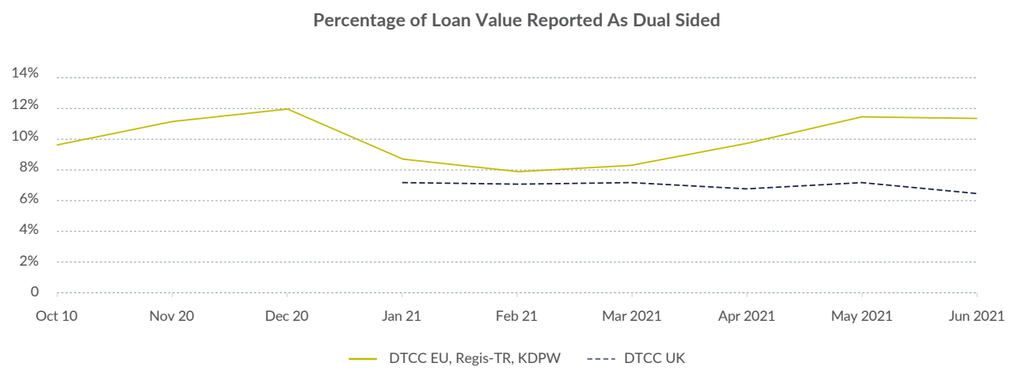
>>> The vast majority of SFTR reporting is single sided

When we compare the percentage value of reported SLEB transactions which are single-sided, (transactions where only one party is captured by the relevant SFTR regime) and transactions which are dual-sided (both parties captured under one SFTR regime, and therefore the transaction is reconcilable), we see that only 8-12% of DTCC EU transactions and 6-7% of DTCC UK transactions are dual sided.

This perhaps shows that most of the liquidity within European securities lending markets are coming from outside of Europe. Arguably the large dip at the end of the Brexit transition period for DTCC EU (around 3.4% in dual sided reporting) gives us some indication about the level of liquidity which comes from UK markets into the EU.

This raises important question about market liquidity and financial stability given the EU's apparent reliance on liquidity from the rest of the world.

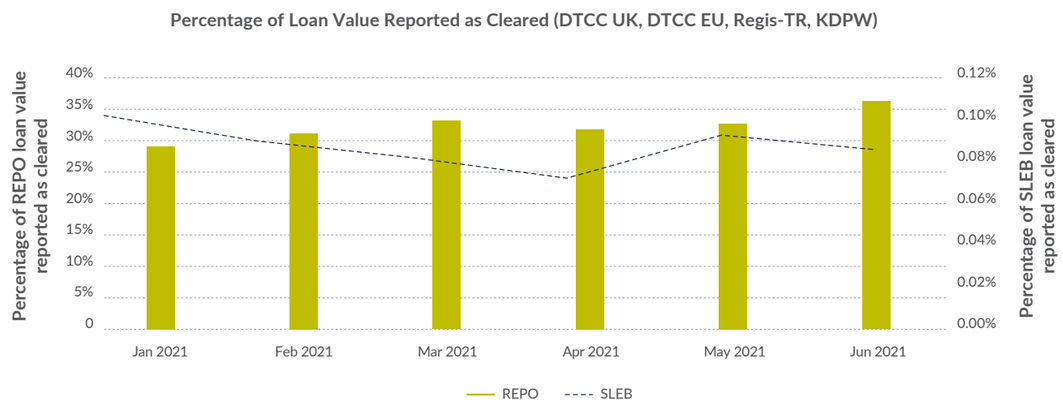
Fig 12 - DTCC, REGIS-TR & KDPW Public Data



>>> CCP clearing is not utilised within securities lending

One element of the TR public data that is overwhelmingly clear is the lack of CCP usage within securities lending markets, CCP cleared transactions made up less than 0.1% of all securities lending volume in the first 6 months of 2021. When compared with repo we see around 30-36% of reported loan volume was cleared using a CCP. The absence of CCP based securities lending products in Europe means this is unlikely to change.

Fig 13 - DTCC, REGIS-TR & KDPW Public Data



>>> Although the number of issuers who are missing LEIs is decreasing, it remains a significant issue

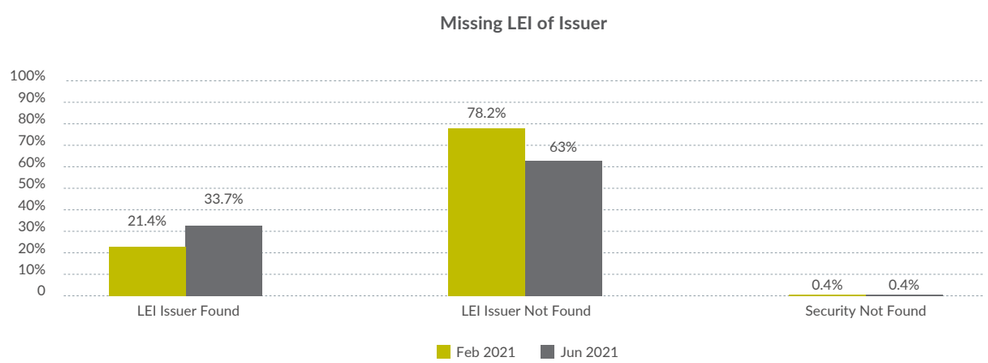
Looking beyond the TR public data, using data gathered by ISLA we can look at the state of LEI coverage. Following a joint communication by ISLA, ICMA, AFME, and AMAFI, both the UK (FCA) and EU (ESMA) regulatory authorities extended the forbearance for a further one year and 18 months respectively. A welcome respite, however significant further work is required to avoid a cliff edge when the extended forbearance periods end.

In February 2021 as we edged towards the end of the first LEI forbearance period granted by ESMA in April 2020 (which allowed firms an additional year of not being obligated to report the LEI of issuers for non-EEA securities) ISLA conducted an extensive study regarding the state of global LEI coverage with the help of members who submitted ISINs which were missing an LEI in their internal static data.

From data received from IHS Markit, we were able to compare the 47,570 submitted ISINs with the GLEIF LEI database, and found that 37,207 ISINs were missing an LEI. Of the total submitted ISINs this represented 78.22% of submitted ISINs missing an LEI. Re-analysing the data in June 2021 shows that this figure has improved by 15.28% to 62.94%. We are pleased to see ISLA's advocacy efforts start to bear fruit in this space, however further work is required to continue closing this LEI gap before the end of the extended forbearance period.

ISLA will be coordinating another large LEI study to discover the widest possible view of missing LEIs in Q3 2021. We will also be working with GLEIF and ANNA to promote global use of LEIs through initiatives such as GLEIF's Registration Agent programme (Registration Agents - Get an LEI: Find LEI Issuing Organizations - About LEI – GLEIF) and ANNA's LEI mapping project (ISIN to LEI Mapping Initiative - Association of National Numbering Agencies (ANNA)).

Fig 14 - ISLA & IHS Markit



More details and further breakdown of these statistics can be found here:
https://www.linkedin.com/pulse/lei-issuer-securities-financing-transaction-que-phuong-dufournet-tran/

Conclusion

Although the data provided by TRs required further work to improve the data quality, there are clearly trends that are consistent with broader market sentiment. We hope to see the data quality improve over time, and ISLA will continue to track these indices to gain a deeper understanding of securities lending markets.

What are your thoughts? We would welcome any feedback and questions from readers.

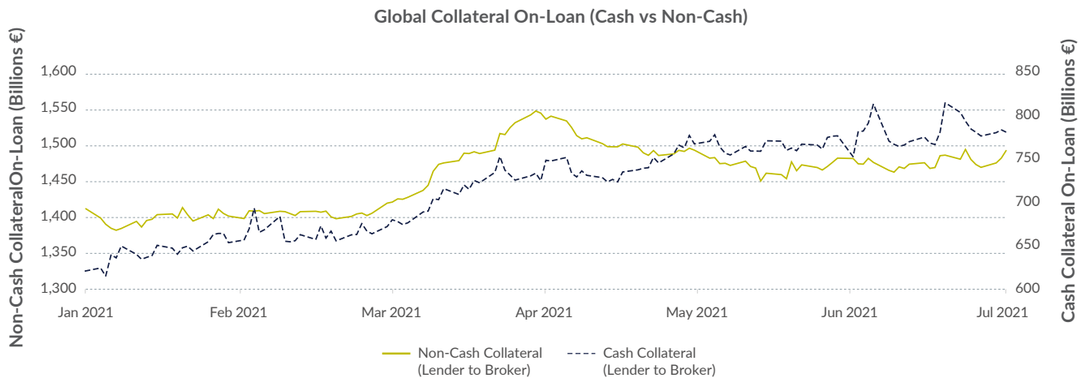
Collateral Dynamics

As our markets have grown and evolved the role of collateral has also changed. From simply being a risk mitigant against loss in the event of a counterpart default its form and composition can now, in many cases, define the economics of a trade. Prior to the 2007/08 crisis we saw how expansive cash collateral reinvestment programmes could be used to drive overall performance. Looking back with the benefit of hindsight it is unlikely that programmes structured in this way would be seen as desirable by today's risk averse standards. Today, a different set of fundamentals and drivers increasingly determine the way we think about collateral.

As other markets and products demand greater and more astute use of collateral, we may see an increasing desire to try and optimize the use of collateral on a cross product basis, although the operational and legal challenges of doing this should not be underestimated. The investment in infrastructure, systems and legal support needed could be prohibitive especially if desired outcomes around areas such as capital usage are not certain.

We have been tracking the development of collateral usage as part of our Securities Lending Market Reports for several years and as at the 30th June we saw some 66% of all loans collateralized with other securities (non-cash) and 34% being collateralized with cash collateral.

Fig 15 - DataLend



As our understanding of the collateral environment has developed over time, we have seen how the market in Europe has moved progressively away from the use of cash collateral preferring instead a model that allows borrowers to mobilize inventory held within their own trading books or on behalf of their underlying clients. As of the 30th of June, 95% of all reported transactions in European equities and bonds were against non-cash collateral with certain bond markets trading exclusively against non-cash collateral.

The picture in North America was somewhat different with non-cash collateral representing only 65% and 50% of fixed income and equity loans respectively. One of the factors that has led the divergence between Europe and North America has been the acceptance of the use of equities as collateral in Europe. Following the 2007/08 financial crisis the market moved away from using corporate bonds as collateral due to concerns about market liquidity during times of stress and the ability to effectively liquidate these assets. Conversely equities and especially mainstream equities provide both better liquidity and effective price discovery allowing for better risk management. Although the arguments for using equities may appear compelling their wider acceptance in North America has been slow and we are still waiting for broader regulatory approval for their use in North America and consequently further use of non-cash collateral in north America has hit something of a ceiling.

Another factor that supports the greater prevalence of cash collateral in North America is the deep and liquid short term cash markets available to cash collateral managers in US Dollars.

As collateral markets in Europe have developed around the non-cash model, we have seen how market participants have actively been able to manage their firm's inventory as well as pursuing balance sheet and regulatory efficiencies We have talked before how borrowers are able to enhance their prudential Liquidity Coverage Ratio's by borrowing HQLA assets for periods in excess of three months, whilst as the same time potentially collateralizing those loans with Risk Weight Asset (RWA) intensive equities. The pattern of that activity can be seen within the breakdown of assets held in triparty.

As at the 30th June collateral held with European triparty agents was very much in line with previous historical norms with equites and government bonds representing 45% and 44% of reported collateral respectively. Due to the way in which collateralisation works around market values rather than volumes we have in the past seen equities as a proportion of the total fall away as underling markets have experienced price volatility. As markets have returned to a period of more relative stability in the past six months the collateral footprint has remained constant throughout the period.

Similarly, as we look in more detail at the breakdown of government bonds by domicile of issue, we see a familiar picture.

Fig 16 – Securities Lending Collateral Held in European Triparty

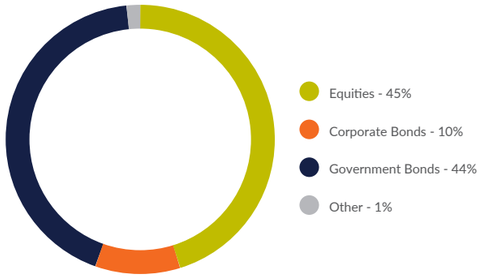
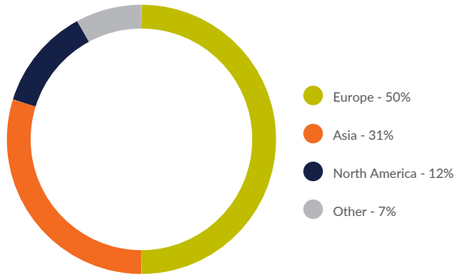


Fig 17 - Government Bond Collateral held in European Triparty by Domicile of Issuers



Not unexpectedly European government bonds dominate the collateral pool representing some 50% of all the circa €900 billion of government bonds held across the triparty system. We have observed before the prevalence of Asian government bonds being used by borrowers and again JGB's represent nearly a third of the government bond collateral portfolio. Again, this highlights how our markets can reflect global diversity within specific regional or local settings. Finally, it is worth noting how little US governments bonds appear to be used as collateral. Notwithstanding the fact that they represent over 30% of all securities on-loan at the 30th June they make up only 12% of the government bond collateral. Whilst the reasons for this may be varied it is perhaps likely that using other eligible securities such as JGB's is more efficient from a cost perspective. It is also probable that US Treasuries command a higher premium as they may be used to support a range of transactions across global securities and repo markets.

In 2018 as part of its commitment to support the use of global master agreements for the securities lending industry, ISLA published a pledge collateral version of our existing Global Master Securities Lending Agreement (GMSLA). This provided an alternative to our traditional title transfer master agreements and allowed market participants to look at concluding agreements with counterparts in jurisdictions where legal set-off in the event of default was not certain as well as looking at alternative ways to potentially manage residual RWA charges associated with over collateralization within title transfer legal frameworks.

Any move away from a title transfer environment to one where collateral is simply held by a triparty agent under a security interest raises important questions for our markets and wider stakeholders. For example, and although we have advocated for some time that most if not all collateral received by lenders is simply held as a mitigant against loss the adoption of a pledge collateral model would essentially rule out any reuse and has implications for any wider discussions around collateral velocity.

Consequently, we have for some time been trying to get closer to understanding to what extent our market has been adopting pledge collateral and what the direction of travel looks like. After working with our partners within the triparty community we have for the first time begun to see some colour around these statistics. Initial data provided this quarter suggests that between 10% and 15% of all business is now being conducted under pledge arrangements.

Separately and discussed in more detail elsewhere in this report we have also begun to see information flows coming out from the Trade Repositories in respect of SFTR data which includes some details of the legal form of the transactions being submitted by market participants. Initial analysis suggest we are seeing similar levels of pledge collateral business being reported here as well

We know that many firms are looking at pledge collateral as a priority for their business models into the remainder of this year and 2022 and we will of course monitor developments in this area with great interest over the coming months.

Data Methodologies

This ISLA Securities Lending Market Report has been compiled using a range of data contributors togetherwith specific information provided directly by our members through surveys and questionnaires.

We would like at this point to thank all of the various contributors for their efforts in assisting ISLA in the production of this report.

Loan information that includes details of securities on-loan across different asset and client types has been provided by three institutions that provide commercial data and benchmarking services for the securities financing industry.

DataLend, IHS Markit and FIS Global all collect data from industry participants on a high frequency basis and provide a range of securities lending benchmarking analytics that allow firms and their clients to better understand and assess the relative performance of any given lending programme.

Whilst each of these data providers covers broadly the same market we have chosen to use data from each to reflect the fact that each has a slightly different business model and client mix and therefore provide different perspectives across certain asset classes or regions.

By adopting this approach, we have been able to develop and publish the ISLA Global Securities Lending Aggregate.

This aggregate, that will be used to develop consistent trend indicators over time, has been compiled by combining information from each of the commercial data providers.

The aggregate was compiled to provide the most representative global estimation of the size and scope of the securities lending markets. In compiling the aggregate, we took the largest securities lending on-loan balance provided by the three commercial data providers as a starting point for the calculation.

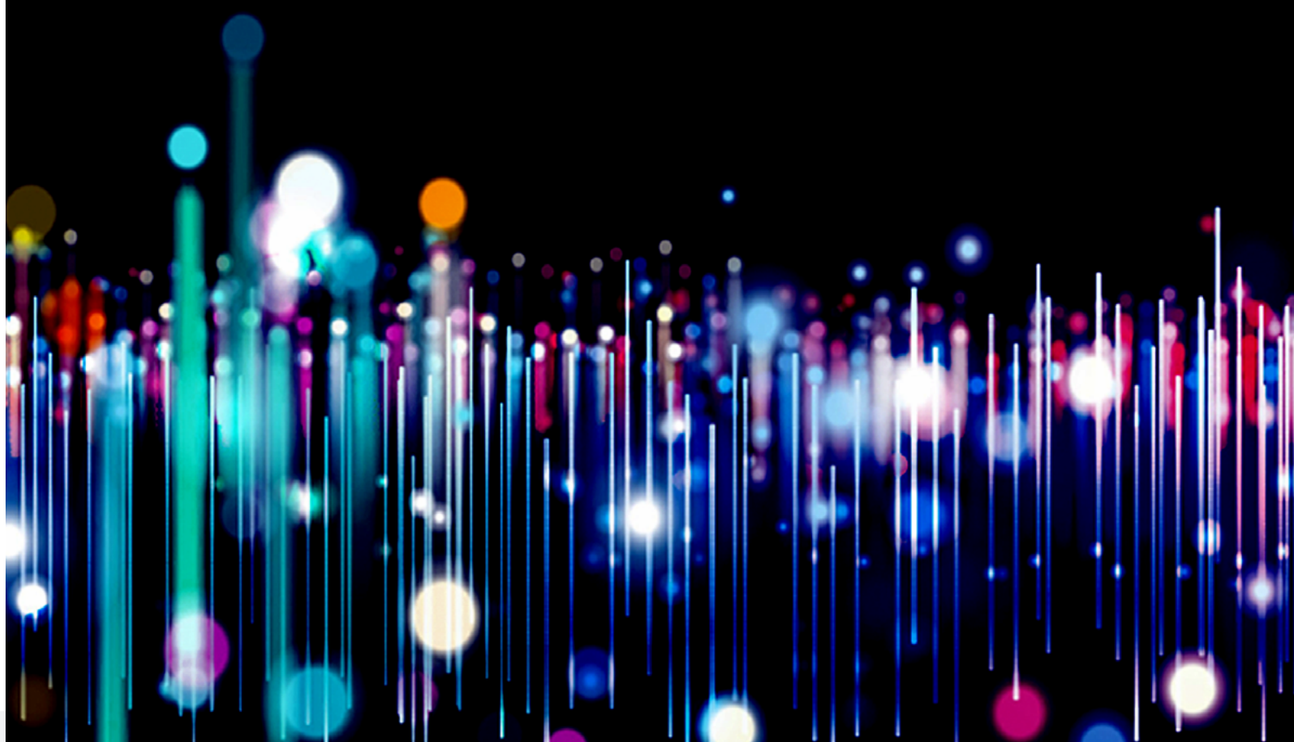
This global on-loan balance was then adjusted to reflect incremental data from the other commercial data providers where their reported on-loan balances across different asset classes or regions created a more representative overall global number.

All regional and geographic analysis reflects the location of the issuer of the securities (as opposed to the location of the lender or borrower) as this is the basis on which the providers collect and analyse their data.

Data from the principal tri-party service providers active in Europe today is also incorporated within the report as part of our analysis of collateral.

Providers

DATALEND	Find out more **www.datalend.com**
FIS	Find out more **www.fisglobal.com**
IHS Markit	Find out more **www.ihsmarkit.com**
BNY MELLON	Find out more **www.bnymellon.com**
clearstream	Find out more **www.clearstream.com**
euroclear	Find out more **www.euroclear.com**
J.P.Morgan	Find out more **www.jpmorgan.com**



ISLA

About ISLA

The International Securities Lending Association (ISLA) is a leading non-profit industry association, representing the common interests of securities lending and financing market participants across Europe, Middle East and Africa. Its geographically diverse membership of over 160 firms includes institutional investors, asset managers, custodial banks, prime brokers and service providers.

Working closely with the industry, as well as national, regional, and global regulators and policy makers, ISLA advocates for, amongst other things, the importance of securities lending to the broader financial services industry. It supports both the Global Market Securities Lending Agreement (GMSLA) legal framework, including the Title Transfer and Securities Interest over Collateral variants, as well as the periodical enforceability and security enforcement across global jurisdictions.

Through member working groups, industry guidance, consultations and first-class events, ISLA plays a pivotal role in the creation and promotion of market best practices and processes, thought leadership, standards for legal frameworks, and securities lending guides and related documents.

General Enquiries

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Disclaimer