



## Securities Lending Performance Measurement

## Introduction & Purpose

The securities lending industry has dramatically evolved and has managed to continue adjusting itself to a wide variety of challenges. Customisation is now the cornerstone of the industry, and market participants can clearly express their risk and reward preferences with finely aligned programmes, offered by a broad range of high-quality agents and other providers with varying attributes and specialities.

At the same time, the use of data has increased and has become essential to the well running and functioning of the market. Having said that, not too much has changed with Securities Lending Performance Measurement (SLPM), in keeping pace or staying in line with the structural and customisation developments. This has led to a common view from many beneficial owners that under the current approach “everyone seems to win”. There are often many valid explanations as to why this can occur, but these anomalies highlight the need for an overhaul and modernisation of the process.

Having an industry-wide global standard, which all participants adhere to in the form of best practice, will eliminate inconsistencies and lead to a far more trusted and utilised methodology. Another factor is the strong regulatory agenda, especially in Europe that is demanding greater transparency and consistency from market participants. Legislation such as MiFID requires the demonstration of best execution principles, whilst SFTR provides detailed scrutiny of trading activities. Set against this backdrop, the securities lending industry needs to develop a robust and transparent framework around SLPM that will compliment these powerful regulatory initiatives. Failure to drive this initiative from within the industry could lead to solutions being imposed upon our markets. The International Securities Lending Association (ISLA) launched an industry-wide working group in early 2019 (see members in Appendix 1) to address these challenges and lead the market through this process.

*“The goal of this initiative is to improve the quality of performance measurements, programme restriction costs and peer comparisons.”*

This best practice guide defines the standards and best practice in respect of both data aggregation and calibration of performance-related metrics.

# Data Governance

High quality and complete data are essential components to ensure that SLPM outputs are consistent and readily comparable. There are three primary areas of data that have been considered by the working group in this regard:

1. Inventory Data
2. Transaction Data
3. Static Data

When looking at the various proposed guidance standards and recommendations, it should be noted that:

- These guidelines do not attempt to harmonize the data requirements across various data providers.
- Data providers may have individual requirements and should ensure data contributors are aware of these. Changes and updates to requirements should also be communicated to data contributors in a timely manner.
- Notwithstanding the individual requirements of data providers, the principals outlined in these guidelines should be closely adhered to.
- The provision of any data in any of these categories should not be managed in isolation, as there are obvious interdependencies between them. For example, transaction data should not be submitted without static data (counterparty, lending fund and collateral) or without reference to the correct and respective inventory.

## Inventory Data

### Problem Summary

There are currently various definitions of inventory. From a portfolio management perspective, all assets may form part of the inventory, however from a securities lending perspective, there may be asset classes or markets within the portfolio that are not lent under existing securities lending arrangements. Even within asset classes and markets that are 'technically' active lending markets, there may be some other restrictions applied at various levels that prevent certain assets from being lent for a specific portfolio. The restriction of assets may have an opportunity cost, and this may be unclear without a clear inventory definition and methodical approach.

### Principle Based Statement

This standard is to provide clarity on the definition of inventory by explaining what should be included and how exceptions are managed. A definition of inventory enables the returns associated with securities lending activity to be measured in a consistent manner against the inventory that generated the returns. Where returns are constrained due to restrictions, the opportunity cost of the restrictions should be clear and may require additional disclosures.

## Technical Standard Guidance

- Data contributors should provide the full amount of inventory to data providers including; markets, funds, securities and asset classes that may be restricted from active lending.
- Data contributors should identify in their submissions to data providers any security which is restricted from lending
- It is recommended that contributors submit additional data points for each line of inventory (per fund) that identify the amount (quantity) of securities that are restricted. It is recognised that this may be achieved by submitting the gross level of securities being made available for lending, with an additional field highlighting either the restricted or un-restricted portion of that position.
- Data contributors should identify in their submissions to data providers, any security which is partially restricted from lending in line with the above principal.
- For the avoidance of doubt, if the data contributor is an agent acting on behalf of an underlying client, restrictions imposed by the agent (including funds, asset classes, markets, securities, buffers, etc) should not be factored into the data submission and should be included and NOT flagged as a restriction. It is anticipated that these downstream calibrations would be applied to specific outputs to put any performance into proper context.
- Where a data contributor on behalf of an underlying client has a requirement to only partially lend a security, the full inventory of that security should be submitted.

The above will additionally:

- Provide for outputs that could show both SLPM relative to actual lendable assets (after restrictions) and all assets (excluding restrictions).
- Allow for the estimation of earnings potential on restricted securities (including markets, funds, securities, asset classes, etc.).

## Transaction Data

### Problem Summary

There is a lack of agreement on the level of completeness and consistency of the transaction data provided by contributors to the data universe. The consistent delivery of all client transaction level data, unless specifically exempted, provides the most comprehensive view of market activity. Either client data is included or excluded, and this should be consistently applied.

### Principle Based Statement

All transaction level data will be consistently supplied by the contributor. Where there are specific portfolios that are to be excluded from the data extract, there should be a rationale retained to log the decision and controls applied to ensure that the exception is consistently maintained. The log of supplied and not supplied data should be reviewed on a regular basis to ensure the data extracts reflect any changes in the underlying portfolio structure.

### Technical Standard Guidance

- All transactions must be submitted; there should be no exclusions or limitations and transactional data should be submitted in a timely manner typically within 24 hours of the close of the relevant trading day. Best practice here should reflect common regulatory submission deadlines associated with reporting regimes such as SFTR.
- Data contributors should provide their entire operating book of transactions across all clients and jurisdictions. Further, data contributors have an obligation to apply best efforts to ensure all submissions are accurate - in fact and content.
- Trade classifications should be clear i.e. those that are “Open”, “Term” or “Exclusive” should be clearly identified as such. Where possible, these classifications should mirror defined terms within relevant legislation such as SFTR and CSDR as appropriate. It should be noted that this is not meant to be an exhaustive list – other trade classifications may exist and/or be specified by a data provider.
- Term structures with “rights of substitution” characteristics should be submitted by data contributors each day if any of the constituent securities change
- The security traded must be identifiable using an industry standard code such as an LEI.
- The collateral posted/received should be identifiable as cash/non-cash as a minimum with non-cash collateral details optional and in accordance with individual data provider requirements.
- Data contributors should ensure that any intercompany/intergroup transactions that do not constitute a market facing transaction are routinely excluded from the data submission.
- Data providers should inform data contributors within 24 hours if any transaction is not processed due to it not passing respective data providers checking processes.
- Data contributors commit to responding to data providers also within 24 hours from the receipt of such notification.
- Transactions should be kept aligned with the books and records of the submitting party i.e. all corrections and other life cycle events must be replicated in the transaction feed to the data provider in a timely manner.
- Where it is deemed necessary to make retrospective adjustments to performance figures, these should be of a material nature and should be discussed with the client.
- All material retrospective adjustments to revenues should be made at the security level where possible.
- All material retrospective adjustments to revenues should be undertaken within one month of the deemed end date of the relevant transaction/s.

## Static Data

### Problem Summary

Data contributors apply different standards to correcting identified data errors and the identification of data omissions. Lack of consistency around identification of client types for aggregation and comparative purposes lead to less than complete peer groups.

### Principle Based Statement

The development and maintenance of relevant and correct static data is of the utmost importance to the implementation of effective performance measurement guidelines. The data contributors accept the collective responsibility of maintaining an up-to-date and relevant data universe, and therefore attempt to resolve known data issues within the agreed period of 48 hours from submission.

Additional detective controls should be undertaken on a periodic basis to review and reconcile other static data elements for completeness as portfolio structure changes over time.

### Technical Standard Guidance

- Static data best practice should be part of new client adoption procedures.
- Minimum requirements should include but not necessarily be limited to the following:
  - o Full legal name of lending counterparty. Here, data contributors should adopt global Legal Entity Identifier (LEI) standards
  - o Counterparty type
  - o Domicile
  - o Tax status (if available)
- Data contributors should ensure the relative standing data requirements are met and maintained on an ongoing basis. This should include providing updates, where applicable when standing data changes and submission timeframes may be according to criticality. For example, a fund that changes collateral static data may be updated on a monthly basis, whereas where missing data that will cause inaccurate trade reporting, such as a missing borrower code, must be updated within 48 hours of original submission.
- Data providers should provide data contributors details of missing static data requirements on a frequent basis but at a minimum semi-annually. Data contributors commit to responding in a timely manner.
- Data contributors should undertake annual audits to ensure all standing data is accurate and up to date.

# Securities Lending Contribution to an Underlying Portfolio

## Problem Summary

The return generated by securities lending activities can be assessed in several different ways and depending on the context of the data consumer, can be subject to misinterpretation or misrepresentation. The challenge is driving consistency and transparency in outputs whilst balancing up the often distinct and different requirements of key stakeholders.

## Principle Based Statement

The quoted return should comply with the agreed definitions and contain appropriate disclosures to ensure that data consumers have a clear understanding of the metric or metrics being used.

It is important to understand and consistently measure and/or compare the overall level of return to a portfolio or collection of portfolios. There are a number of factors that need to be considered and these include:

- Return to assets vs lendable – Portfolio managers, boards and other stakeholders want to understand the contribution of securities lending returns to the value of a fund (i.e. their assets) whilst agents and managers of securities lending programs, require to be judged on the assets made available to them by the asset owners. Often, certain assets within a fund either cannot be lent or are not made available to be lent, thus causing differences and anomalies.
- Securities lending returns – There can be different components to securities lending contribution, including the return from the securities themselves (intrinsic return) and returns (positive and negative) which come from the management of cash collateral. The lending of securities and the management of cash collateral can also be split between different managers.
- Gross vs net returns – Fees and other costs can influence the return to a portfolio or collection of portfolios. Portfolio managers, boards and other stakeholders are interested in the net return to a portfolio (alpha) whilst also wanting to manage costs and fees. When assessing relative securities lending performance (please see subsequent section), fees and costs present quite large variables between programs and it is considered best practice to assess relative performance on a gross basis.

### Technical Standard Guidance

Considering the above and all the various needs of differing stakeholders as well as addressing the need improve consistency and transparency, best practice should be to produce two sets of contribution calculations:

1. Return to assets, including gross, net (after fees, costs etc.), securities lending return, total return.
2. Return to lendable, including gross, net (after fees, costs etc.), securities lending return, total return.

Any fees and costs deducted from revenues should be fully detailed and provide clarity as to what they cover and the basis on which they have been applied.

It should be noted that apart from simple gross returns, more complex outputs including the application of specific costs such as fee splits, are likely to be produced and calibrated by individual service providers and lending agents.

Further consideration should also be given to producing calculations for the securities lending returns on the value of securities on loan.

Where basis point returns are quoted for previous year's performance, the return should be expressed as the actual securities lending return/average assets over the period.

For current period returns, the actual basis point return can be annualised/average assets over the period.

# Relative Performance of Securities Lending

## Problem Summary

Typically, asset owners and managers have their own unique portfolio structures that are governed by investment principles, policy, tax, and regulatory considerations. This makes the task of assessing the relative performance of securities lending programmes challenging and, at times, complex.

## Principle Based Statement

Producing appropriate outputs for SLPM which are clear, transparent, and consistent is important to ensure trust and maintain integrity in the measurement of securities lending returns and performance.

There are many variables and the guidelines below do not look to limit or even dictate the needs of individual firms, but look to set down a set of guidelines and principals that can be applied when delivering, assessing or receiving securities lending performance.

Regardless of the specific calibration providing clear and consistent transparency around the construction and use of peer groups is of critical importance.

## Technical Standard Guidance

- Any peer group should have as close alignment as possible with client portfolio characteristics without narrowing the peer group to a peer group of one.
- Best practice would be where the lender is no more than 25% of the peer group.
- Peer group size, (excluding lender) should always be disclosed, either number of funds or asset size.
- Using one data point may not provide best outcomes so consideration should be given to multiple data points.
- Consider regional (as opposed to country) view and investor style (long term vs short-term investors) as ways of broadening the peer groups.
- Where relevant, historical comparative data is available, outputs should be considered over as longer-term horizon as is practically possible.
- Disclosure:
  - If peer group includes lenders securities or not
  - Alignment on tax rates
  - Collateral profiles
  - Term included or not
  - All portfolio assets or inclusive of restricted assets
  - Optional trades in peer group or not (cash stock options etc.)
- Timing of outputs relative to a trading cycle, especially dividend season.

# Appendix

## Working Group Members

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