Securities Finance Takes Center Stage

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The pandemic has made an impact on every aspect of the financial services industry. But one of the most interesting case studies is the securities finance market.

The world of securities finance has historically been somewhat staid, operating with separate desks for repo and stock loans, organized by region, frequently with separate collateral teams supporting each. More recently, margin pressures and regulatory requirements have encouraged firms to unite these teams through organizational and process changes.

Meanwhile, asset managers had commonly turned to agent lenders to manage the lending of their assets to generate income. But increasingly, managers have started to bring that lending in-house in to order to eliminate agent leader fees.

Then came the coronavirus. The initial and immediate impact on the market was enormous volatility and volumes, which stressed every process and many systems, including the repo market.

At the same time, we saw a “rush to quality” that reduced the availability of high-quality liquid assets (HQLA) such as US treasuries. Quantitative easing by central banks added pressure, quickly driving up the borrowing costs for US treasuries. And regulatory capital is increasingly scarce, forcing banks to shore up balance sheets – some even considered canceling dividend payments. All of these put real pressure to optimize collateral, while lenders looked for additional revenue to offset the volatility and gigantic drops in asset prices.

But we’re not just seeing intraday volatility, we’re seeing continued high activity in securities finance as investors place their bets on which sectors and companies will win and which will lose as the impact of the pandemic continues to unfold.

The industry and technology are coping with both the volumes and the volatility. But as we begin to rebuild from this crisis, we may see the acceleration of some trends.

First, the market is hot and may remain so for a while. But for both borrowers and lenders to maximize those benefits, they will want to understand the complete global book – stock loan, repo, swaps, all collateral and every region, coupled with a complete view of market data. Smart firms will look at their securities finance operation as an integrated function, and they'll demand that integrated view from their vendors. So, we can expect to see more organizational change as well as new processes and technology projects to integrate decentralized functions.

Second, expect more asset managers to in-source lending. There is income to be made, and there are now SaaS-based solutions that allow them to keep the fees once paid to agent lenders, even while continuing to work from home. Technology providers are enabling this by delivering comprehensive, front-to-back securities lending solutions to support the whole value chain, giving firms a view of their whole book, including their collateral.

But there's more to come, because advanced technologies are poised to evolve securities finance even further. If you layer machine learning on top of that comprehensive view of your positions and market data, you can really optimize your decisions. The industry is waking up to this. We'll see increasing applications of artificial intelligence and machine learning to make better decisions, as well as the use of other technologies, possibly including distributed ledger technology, to drive out costs.

As we rebuild the broader economy, the securities finance industry should be ready to up its game by embracing integration and technology for smarter decisions and better outcomes.

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