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Adding Value Through *Securities Lending*

In the midst of volatile trading conditions, lending securities in your portfolio can provide a stable source of income, with the loan fully secured by liquid collateral and further protected by BNY Mellon borrower default indemnification.

In this article, BNY Mellon's Agency Securities Finance team explains some of the basics of securities lending and details how lending can deliver meaningful performance enhancement to your portfolio even in the face of market volatility.

What is securities lending?

A securities lending transaction is a temporary loan of securities between a lender (known as a beneficial owner) and an approved borrower. The loan is typically short-term and secured with collateral, either cash or high-quality securities, such as government bonds.

Why should I lend my securities?

Assets sitting in your investment portfolio may have incremental revenue potential beyond dividends and price appreciation. By lending out those assets, you can unlock that potential by collecting fee income from a borrower who wishes to temporarily obtain securities you own.

What securities can I lend? And what collateral would I receive against the loan?

You can lend global equities, corporate bonds, government securities and supranational debt.

The collateral you can receive includes cash (in US dollars, Euros, British pounds, Japenese yen, Canadian dollars or Australian dollars) and non-cash collateral including sovereign debt, global equities, investment grade corporate bonds, specific supranational debt and specific equity index baskets.

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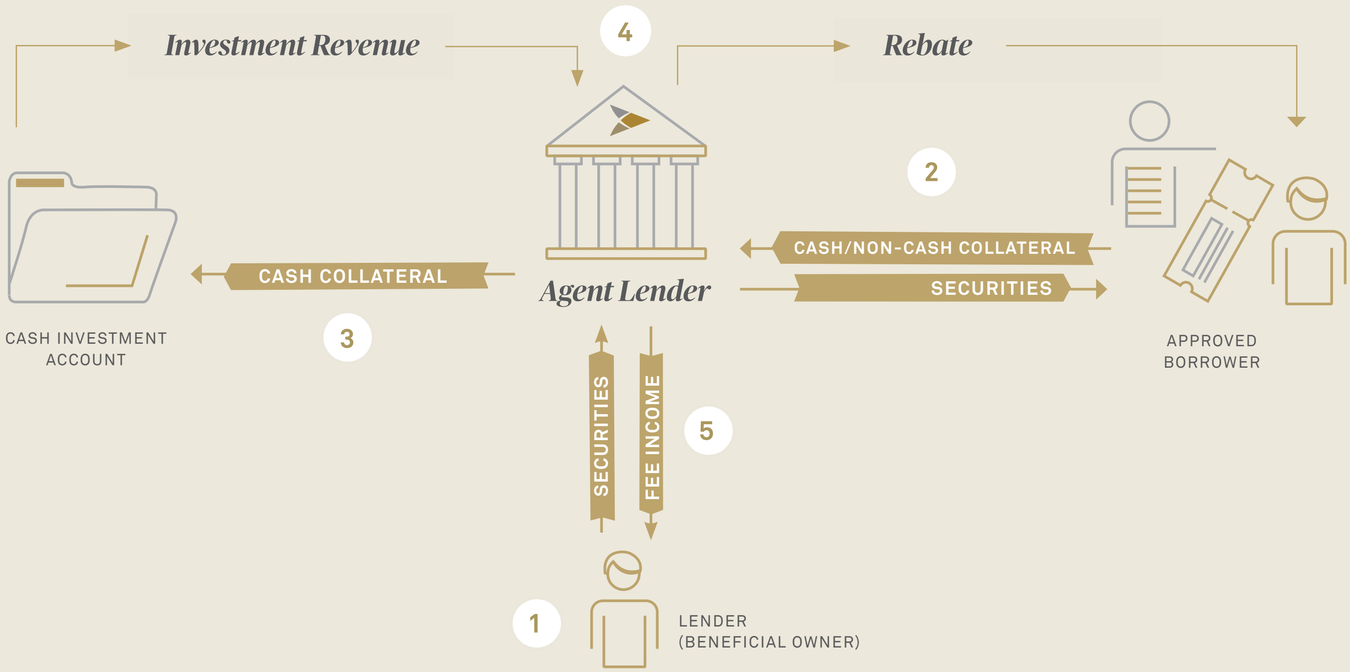
How does agency securities lending work?



1. As a beneficial owner, you onboard with BNY Mellon as a member of our Agency Securities Lending Program. You stipulate the securities in your portfolio you are willing to lend out and identify the types of borrowers to whom you are willing to lend.

2. As your agent lender, we share your inventory of lendable securities with our community of approved borrowers. A borrower instructs us that they wish to borrow a lendable asset, posting cash collateral or non-cash collateral against the loan in excess of 100% of the market value of the borrowed securities.

3. We invest cash collateral in money market instruments for the duration of the loan. When collateral consists of securities, a fee is negotiated for the loan shared between the beneficial owner and the agent lender.

4. When cash collateral is pledged, a rebate on the posted collateral may be paid to the borrower. The rest of the revenue is shared between the beneficial owner and the agent lender based on a pre-negotiated split.

5. The revenue from the loan is credited back to your account. At the conclusion of the loan, the borrowed securities are returned to your portfolio.

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Why should I consider lending my securities during this period of market volatility?

Securities lending is a countercyclical investment product that typically generates increased revenues for lenders during volatile market conditions. This is due to higher transaction volumes, an increase in the number of in-demand securities (“specials”), wider spreads in turbulent markets and increased demand for certain sovereign bonds, especially US Treasuries, during a flight to quality.

In addition, securities lending can act as a hedge, especially for passive strategies and strategies that track or seek to replicate an index.

If I decide to lend my securities, what safeguards are in place to protect them?

Risk in securities lending is managed using a range of tools designed to protect you and your assets.

Overcollateralization

All loans are overcollateralized. This means that the borrower generally posts collateral equal to 102% of the value of the securities being borrowed. If the collateral is denominated in a currency other than that of the borrowed security, the overcollateralization rate increases to 105%. In some cases, certain transactions, such as upgrade trades, are collateralized as high as 110%.

Mark-to-Market Valuations

We apply daily mark-to market valuations to ensure that all loans maintain collateral sufficiency. In the event that more collateral is required, as your agent lender, we will issue a margin call on your behalf and collect top-up margin that reflects the change in the value of the loan and the collateral supporting it.

Netting

Netting arrangements may allow you to share in a pool of excess collateral in the event of a default of a borrower, further reducing risk.

Ongoing Monitoring and Stress Testing

To ensure that all borrowers remain within applicable credit limits and to evaluate the robustness of our lending program, we periodically run simulated market shock events.

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Indemnification

BNY Mellon provides borrower default indemnification, supporting you with the strength of our balance sheet and high capital levels, enabling you to extract additional alpha from your portfolio without a material increase in risk.

What happens if a borrower defaults while in possession of my securities?

If a borrower fails to meet a margin call or fails to return loaned assets when they are recalled, posted collateral is liquidated and the proceeds used to purchase replacement securities that are then placed into your portfolio. Overcollateralization, daily mark-to-market valuations and borrower default indemnification mitigate the risk of a collateral shortfall when replacement securities need to be purchased.

Has BNY Mellon made any recent changes to strengthen its agency lending program?

Among the additional protections we've introduced in recent years, rather than commingling client cash collateral in investment vehicles in a pooled account, cash is reinvested via segregated accounts, eliminating client concerns that they may be "last out." In addition, we have shortened durations and increased liquidity in the cash reinvestment program.

What role is new market infrastructure like central counterparties (CCPs) playing in lending and funding markets?

The past two years have seen the launch of central clearing for certain securities lending and cash reinvestment transactions. Central clearing allows lending transactions to be guaranteed by a highly regulated CCP. It is also the only distribution channel in securities lending in which demand exceeds supply and borrowers are willing to pay premium prices to clear trades.

Using BNY Mellon as lending agent, lenders can enjoy the benefits of CCP membership but without many of the obligations, such as contributing to a default fund and exposure to risk mutualization. With our borrower default indemnification layered on top of this, these transactions tend to be extremely low risk, even in current market conditions.

We are currently the only agent lender offering clearing of securities lending transactions through **Eurex Clearing**. Repo transactions involving a lender posting US Treasuries as collateral

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and cash collateral invested in US government repo can also be centrally cleared through the Fixed Income Clearing Corporation (FICC) via a sponsored membership arrangement with us.

Is securities lending beneficial for global financial markets?

Yes. Lending your securities, especially during a time of stress, provides much-needed liquidity into the market. Securities loans help borrowers to avoid settlement fails, access high-quality liquid assets to meet regulatory requirements and assist in facilitating hedging strategies.

There is also an extensive body of literature on the positive role that securities lending plays in providing market liquidity. Central banks including the **Federal Reserve** and the **Bank of Canada** have published research on this issue, while regulatory bodies including the **Bank for International Settlements** and **IOSCO** have reached similar conclusions after a thorough analysis of the sector.

For more details about how you can earn supplemental yield through participating in BNY Mellon's securities lending program, please email: BNYMSecuritiesFinance@bnymellon.com

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