Navigating complexity

Flexibility, technology and risk management are all necessities for conducting business in the Asian securities lending marketplace, says Dane Fannin of Northern Trust. Mark Dugdale reports

What are the common characteristics of successful securities lending programmes in Asia?

Three aspects in particular stand out: firstly, a flexible programme to ensure the agent lender remains adaptable in what is an ever-changing market environment, allowing the appropriate responsiveness to capitalise on idea generation and align parameters with evolving client needs. Given Asia's rapidly evolving market landscape, agent lenders must remain proactive, continuously repositioning their business, and ready to execute on emerging opportunities for clients.

Secondly, dynamic technological capabilities are a necessity to facilitate change and drive increased efficiencies in the pursuit of automation. The latter is particularly relevant in Asia from a trading perspective, where an investment in trading automation unlocks significant value for clients in allowing traders to focus their efforts on 'special' securities and idea generation.

Thirdly, a robust risk framework is paramount to securities lending in Asia, given the complexity in market structures and the risks this presents in respect to operations and liquidity management.

How does the market in Asia differ from the US or Europe?

The most striking difference is in the comparison of maturity profiles. While the US and Europe are relatively developed securities lending markets with limited growth potential, Asia boasts an impressive landscape of untapped emerging and developing markets with attractive revenue profiles, such as China and India.

However, Asia's less mature configuration carries the burden of being comparatively more cumbersome in execution from a trading perspective, given a lack of commonality in framework and regulation across markets in the region.

Notably, clients shouldn't forget that often it is the lack of standardised frameworks that present the most compelling opportunities in Asia, hence the value in agent lenders having the means to navigate these complexities accordingly.

What sort of returns are possible in Asia?

Returns are generally expected to be greater in Asia relative to other global hubs, because of both structural and market factors. On the structural front, Asia is inherently a riskier jurisdiction for participants. The risk is largely derived from the punitive settlement regimes and the structures in which numerous markets operate, which typically constrains liquidity in supply.

As such, expected returns are generally higher and are usually in comparatively higher spreads at the security level.

From a market perspective, there continues to be significant end-user demand for exposure to the Chinese economy, and in the absence of a viable means to transact securities lending onshore, flows typically take place in those Asian economies with direct or indirect economic ties to China, such as Australia, Hong Kong, Malaysia, South Korea and Taiwan. Our expectation is that this will continue to be the case, which should drive healthy revenue streams for clients invested in those markets.

What types of collateral are Asian asset owners typically demanding in exchange for their securities?

Asian clients remain sophisticated in outlook and willing to partner with those agent lenders able to offer a keen working relationship to drive their securities lending programmes forward by being adaptable to changing conditions and requirements.

Our experience is that clients want to engage directly and understand where the next opportunity or development is coming from. Securities lending is not merely a custody ‘add-on product’, it is an independent and strategic business that forms a critical part in helping clients achieve their performance goals.

Finally, how has the market changed in recent years?

The most notable change has been one applicable to the securities lending business globally, derived from the implementation of regulation, particularly Basel III. Under its application, equity finance desks have increasingly been used as the vehicle to manage balance sheet efficiencies and achieve liquidity targets, inducing the need for borrowers to fund themselves on an increasingly longer-term basis. This has presented new trading opportunities for agent lenders and has tasked the business with thinking about the maximisation of inventory quite differently, essentially in a more strategic and proactive manner.

The other important change in Asia has been the development of the offshore securities market for China, notably the Shanghai-Hong Kong Stock Connect scheme. While the securities lending and short selling rules within the scheme remain entirely unworkable in practice, it has been an important milestone for the development and liberalisation of the Chinese market. The speed of its development is also a stark reminder of the pace at which China is able to implement change, and participants remain optimistic for further change that could potentially open up a significant opportunity for the market. **SLT**

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Dane Fannin
Head of securities lending, Asia Pacific, Northern Trust