Right of return

4Sight's sales director speaks to SLT about how swaps are affecting the securities lending market

BEN WILKIE REPORTS

SLT: Has 4sight seen significant growth in swaps as a synthetic securities lending and borrowing product?

Robert Palliser: Yes, many of our customers run integrated securities finance models across all asset classes and trading structures. As such, they can optimise their use of balance sheet, capital, and bottom line earnings by carefully choosing both the counterparts that they deal with (other brokers, agent and/or direct lenders) and also the trade structure they use (stock loan, repo, cash/OTC derivative and cash trade/single stock futures).

As a result, they are increasingly looking for an integrated software product that allows them to undertake trade capture, maintenance and collateralisation across all physical and synthetic securities finance product types.

In addition, firms are seeking to differentiate their offerings through the ability to give their clients access to a given security via a variety of different trade structures.

There is also a need to optimise the collateralisation of any exposure across a wider range of products and this is achieved through making more effective use of idle long inventory, especially equities.

SLT: Is there growth in demand for a specific trade type?

Palliser: Growth is predominantly in two areas. Firstly as a direct alternative to a loan/borrow transaction. Secondly, for the financing of long inventory.

The former has been long established as a means of providing market access in jurisdictions that traditionally did not allow for the standard securities lending and borrowing structure.

The latter is part of the continued development of the financing market place, where the more innovative firms are increasingly offering more bespoke trade structures and pricing. This is through a variety of means, including physically, (via evergreens, extendables etc), or synthetically (via cash sale and Total/Price Return Swaps).

SLT: How are your clients seeking to integrate swap activity with their traditional securities lending and borrowing activity?

Palliser: There is a drive to integrate swap activity across all areas of trade capture, maintenance and collateralisation. So for example, firms want the ability to easily choose between physical and synthetic securities finance trade structures directly from the inventory/position monitor in their software solution. After checking in the system that they have access to a given security or basket of securities, they can then arrange for these to be "lent out" or "financed" by a chosen third party.

They are also looking to factor in the cash legs on any synthetic securities lending and borrowing activity into their cash ladders and asset & liability management activities. Most importantly, they are seeking to bring all synthetic exposure management into an integrated collateral management and optimisation programme across asset classes. This enables them to retain liquidity, optimise use of balance sheet/capital and minimise collateral costs.

SLT: How do you see the future landscape of standard and synthetic securities lending markets developing?

Palliser: If the market continues to develop at the pace we have seen over the recent past, it is possible that synthetic products could largely be interchangeable with standard borrowing and lending transactions in the future.

Market counterparts will therefore determine the optimal structure to use based upon the underlying trade rationale and subsequent capital/balance sheet usage.

There is currently a clear dichotomy between institutional lenders who lend securities and nothing more, and broker dealers who then on-lend or provide access synthetically to such securities. However, this is rapidly disappearing.

The evidence of this is the increased interest we are seeing across our entire client base in capturing or managing all of their synthetic and physical securities lending and borrowing activity within a single system (whether structured via an OTC derivative, listed future or equity performance note).

Finally, there will potentially be a migration or novation of physical securities lending and OTC derivative activity onto common centralised exchanges. This will also bring the differing securities finance structures even closer together.

SLT: How can technology systems support the use of synthetic finance?

Palliser: Firstly, the consolidation of any synthetic exposures with those derived from the more traditional securities lending and repo activities has undoubted benefits. This allows the "creation" of a single collateral pool and this is important in any effective collateral management and optimisation process.

Furthermore, the linking of physical and synthetic structures in a single system has significant advantages from a corporate action processing, liquidity and risk management perspective. It allows for a wider, portfolio approach to be undertaken. In addition, software solutions provide a level of automation that allows firms to handle the complexity of synthetic trade structures more easily and trade at higher volumes without placing an additional strain on the back office.

Finally, regardless of a given institution's role within the securities finance market, the ability to provide clients with a wider range of trade structures – each with quite different characteristics and benefits – should ensure more effective trade pricing and client retention.

This, along with the ability to communicate key information to customers in a clear and transparent manner, will help firms provide added value and differentiate themselves from their competitors. It will also provide greater transparency from a regulatory and management information reporting perspective. **SLT**