Actively engaged

Craig Starble, CEO of eSecLending, reflects on how running segregated accounts for each client is key to the company's business proposition.

Clients have different objectives and demands. How does eSecLending address this diversity?

eSecLending was founded 22 years ago to improve the client experience in the securities lending market, with one anchor client. Fast forward to the present and many clients since, our focus is still on providing that one single service. I think we do it well.

The reality is that every client wants something different from their securities lending program. They each have different guidelines, collateral and risk profiles, and sensitivities that can drive restrictions and custom requirements.

We adapt each program to a particular client depending on their risk profile. This isn't necessarily how it's done across the industry but that's what set this business apart in the beginning and it is still how we chose to do it.

The beauty of running segregated accounts for each client, which is very different from a pooled program structure, is not only can we adapt to each client, we can also look at their businesses at an individual level. I believe that has added to performance and to client satisfaction. It allows us to be very flexible when the client wants to make changes to their program – for instance, we can accommodate virtually any custom requirement related to minimum spreads, buffers, collateral profiles, ESG and proxy voting as well as specific restrictions that may be imposed by the portfolio managers themselves.

As I've mentioned before, different clients have different considerations for their collateral sets. Whether it's a cash reinvest strategy, taking equities as collateral or sovereigns only as collateral: all those elements are important to individual client sets. I think we do well at recognizing and adapting to the differences among clients.

Let's talk about performance, a key driver for lending clients. What's your strategy on optimizing those programs for your clients with performance in mind?

Performance is important for all clients, but every client has a different definition of performance.

Our strategy always starts with the same thing: we recommend that a client auctions their portfolio because it gives us its true value as defined by the borrower side of the market. Of course, all assets that are auctioned don't end up going into an exclusive, but we get true visibility into what that portfolio is worth. This strategy is unique to us and the information and pricing intelligence is only seen by us and our clients. This gives us a competitive advantage when understanding and assessing borrower demand.

What happens from that point is the client will decide whether they want to assign certain assets into an exclusive with various borrowers. From there, portfolios not allocated to exclusives are lent like everyone else lends them - on a discretionary basis, every day.

We do both of those trading strategies well, but we believe that the combination of the two disciplines create outperformance for the client. In an exclusive, borrowers are interested in locking up inventory for a period. This optionality allows them to pay more (and sometimes significantly more) for those assets than they would otherwise pay on an as needed daily basis.

We have done this for 22 years. The first client we brought on auctioned their securities, and there was an exclusive established as a result. It's been something that clients have used to create outperformance in the market over time. The assets that perform the best in the auction are those with the highest demand profile such as small cap equities, emerging markets equities, high yield bonds etc.

Borrowers don't typically pay a premium for general collateral (ie large cap assets like S&P 500 equities, investment grade corporate bonds or government bonds). We typically lend those securities on a discretionary basis.

In a separate account structure, we also look at specialty trades, structured trades, or certain one-off collateral trades in a client centric manner. We optimize each client's portfolio by not impacting those of other clients at the same time.

When using a separate account structure, our traders strategize with our clients about how best to optimize the assets they have in their portfolios considering term structure or collateral types, and work with the borrowers to create a structured transaction that's good for both sides. Clients who participate actively in their lending program will outperform those who don't.

An important part of a separate account program is that we can look at individual structures with the borrower base to the advantage of the client. When we do an auction, we focus only on one client's portfolio or assets at any one time. We don't aggregate various clients in that auction - it's always done on a bespoke client-by-client basis.

If we turn our attention to product innovation and innovation around types of transactions as well as counterparties. How are you as a company evolving around this changing landscape and addressing the evolving needs of some of your clients?

I believe we must be flexible enough to change with the market. Clients expect that from us.

We work with them to ensure they have a flexible collateral profile because it increases market opportunity. For example, some clients will only take treasuries or sovereigns as collateral. As a result, they have different opportunities than those clients who will take a broader range of collateral sets.

What we've seen change over the years, and where we have adapted, is demand on the borrower side. Capital restrictions and regulatory capital requirements for borrowers have incentivized us, our clients as well as the borrowers to come up with different trade structures that optimize the risk weighted asset [RWA]/capital impact to the borrower.

"We spend a lot of time working with both the client and the borrower to come up with optimized structures that benefit both sides. You must be able to innovate to make it a win/win for everyone."

We spend a lot of time working with both the client and the borrower to come up with optimized structures that benefit both sides. You must be able to innovate to make it a win/win for everyone.

Historically, we've seen borrowers challenged by regulatory capital considerations, RWA impact or the LCR impact. As an industry, we have questioned whether to transact through a CCP or via the Pledge structure, or by going direct to the underlying borrower; all can be viable options depending upon the client profile and risk appetite.

But the reality is that we found it very beneficial to interact with borrowers on a direct client basis, to meet their needs around capital, and the needs of our clients from a performance perspective. That's changed the way we do business.

We're also starting to see material capital impacts to the business amongst the traditional agent banks in the business. Indemnification for agent bank lenders is a capital-intensive proposition. Certain banks can't do or have chosen not to do high notional/low spread loans for their clients. We are in a unique position as a specialist agent lender since we do not fall under the same regulatory structure as our competitors. This allows us to accommodate those transactions based on how we acquire our indemnification: we purchase indemnification insurance from insurance carriers. It means we have a fixed cost for indemnification, which allows us to do these innovative transactions, among other things. Clients respond well to it.

Many clients now want to do financing trades where they're taking unused general collateral to raise cash funding and create leverage in their portfolio. We lend the securities out and we give them the cash collateral for them to use in their holistic total plan leverage or liquidity strategies.

We have clients who are looking at funding various portions of their other businesses, whether it's real estate or infrastructure assets, for example. Those transactions tend to be high notional/low spread transactions. It's a low spread type of transaction, but for us, it's a quality transaction, and it provides funding for the client. More importantly, it allows them to expand their other businesses by using securities lending as the financing tool.

To expand on the innovation topic, another area to watch is around peer-to-peer [P2P] transactions. We like being the facilitator of those transactions and are seeing a pickup in that opportunity. It will take time to develop further because clients must approve each other as counterparties. But many of our clients are now looking to engage with each other on certain transactions. They may not be lending special stock to each other, but many financing transactions are being done between clients via P2P.

We've talked about client needs and demands, innovation and performance. Something you touched upon is the fact that securities lending is a capital

constrained business at its core. How do you think this is affecting the current landscape but also the beneficial owner side of the equation?

Beneficial owners probably don't feel like they've been dramatically impacted yet by capital constraints, because specials trades and trades of value are still being carried out. The RWA and regulatory capital impacts are limited because of the earnings related to those transactions.

However, banks can be hesitant to execute structured and general collateral or funding driven trades where there's high notional/low spread. Whether the beneficial owner knows it or not, they're probably leaving some revenue on the table if their agent lender is a bank subject to these capital constraints.

Every bank has different restraints and is managing to different metrics. There's no clear-cut rule about the quality of a trade. But whenever you have a situation where RWA/Capital is looked at prior to a transaction, the result is going to be the client getting less revenue from that agent lender.

Because of eSecLending's indemnification proposition, and how we manage it, we're an efficient capital play for clients. Clients who want to do these financing trades or make revenue from a high notional/low spread business can come to us: I would say we have a more efficient capital structure today than many of our competitors.

We are a smaller company, and some clients are challenged by that. But the reality is that once they understand the value of our indemnification and the benefits it provides, they turn to us.

Craig Starble

Chief Executive Officer, eSecLending

Craig Starble is the Chief Executive Officer at eSecLending where he leads the development and implementation of eSecLending's overall strategy. Craig joined eSecLending in 2013 and began his career in financial services in 1984. Prior to eSecLending, Craig was the Founder and CEO of Premier Global Securities Lending, LLC (PGSL), Executive Vice President and Head of State Street Bank's global securities lending division from 2004 to 2009, was a Co-Founder and CFO for Shoebuy.com, and was Managing Director for the Treasury Funding Group at BankBoston Corporation. Craig received a Bachelor of Arts in Economics and Government from Connecticut College.

Amelie Labbe, Global Investor, speaks to Craig Starble, Chief Executive Officer at eSecLending.