Rethinking the investment process

Vikas Nigam, director, head of Americas for agency securities lending at Deutsche Bank outlines the development of the bank's US business and the diversification of use cases in this significant market.

When global markets plunged in March 2020, many Deutsche Bank clients in the US - particularly state treasurers and state pension funds - feared that with lower tax revenues and increased healthcare and employment costs, they would face a liquidity squeeze.

"We provide a high touch service resulting in deep client engagement," says Nigam. "So when Covid first hit, our clients naturally engaged with us to see how best to unlock liquidity from their securities lending portfolio as an alternative to an outright sale. However, when policy makers stepped in with monetary and fiscal measures, some clients found themselves with the opposite problem of having to manage an excess of liquidity."

This created issues around low yields and a lack of investment returns, which led to an increased focus on securities lending as a way of driving the incremental return clients

need. With so much cash in the market from money funds in particular, there was a lack of investment options and repo collateral available.

In light of this opportunity and reflecting the ongoing diversification of use cases, Deutsche Bank moved its securities lending business across to the cash management arm of the bank.

"We rethought the investment process from the ground up to deliver a front to bank investment process to clients to invest their excess cash in our reverse repo and money market offerings," says Nigam. "Not only was this available to our existing securities lending clients, but with our realignment to cash management we are also expanding our reach to a much larger client base."

Another way the bank differentiates itself is by maintaining a proactive approach to market and regulatory developments. "A good example of this is the recent implementation of the net stable funding ratio (NSFR) by broker dealers globally, which has resulted in newer trade structures in the market," explains Nigam. "This allows us to engage with our clients around the expansion of guidelines to make their portfolios more attractive."

"Flexibility is really going to be a key theme over the next 18 months," he adds. "Clients will need to be flexible to adapt and help counterparties become more efficient from a regulatory standpoint. Counterparties will need to be flexible as clients shift attention and focus to embedding ESG into their investing and securities lending process."

According to Nigam, that level of engagement is going to be there for as long as clients want it. "We appreciate that not all clients have the bandwidth to focus on securities lending to the extent that they might want to and while they are engaged and wanting to talk to us we are happy to keep talking to them about all the things we are seeing."

In terms of use case diversification, an obvious example is tapping the cash collateral pool as a way of helping fund other needs. Deutsche Bank is currently engaging with a client that is looking to monetise its treasury portfolio under a term structure, prioritising liquidity management over revenue generation.

"Another use case is where investment managers are adapting their investment strategy based on the additional revenue they are able to earn from securities lending," says Nigam. "They are now using securities lending revenue as an added input into their portfolio selection and construction and using us as an agent to help price and generate alpha for their client."

As an example, clients can choose to buy a TIP with a higher yield and lower associated securities lending revenue or a Treasury Bill with a lower yield but a higher securities lending return based upon their near 100% demand from a securities lending prospective. The same applies to equities, where clients have to decide whether to go for a swap or hold the equity and have securities lending revenue attached to that.

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different segments from asset managers to insurance companies and pension funds, but its US business is predominantly public funds.

"This is pleasing for a number of reasons," observes Nigam. "Public entities have some of the most stringent and transparent selection criteria, so we are obviously doing something right for them to choose us. Secondly, Deutsche Bank isn't a household name compared to some of our US peers so for these entities to feel comfortable enough with us to select and push for us with their boards over a household name shows the level of confidence we have generated. That in itself is an incredibly powerful endorsement."

"Clients have stayed with us throughout our transformation journey and now that we are on a much stronger footing we are growing our mandates with them," he adds. "They are giving us additional assets or widening their guidelines with us and we are looking to sell to more clients and expand our offering."

The investment in the securities lending programme in terms of technology has been a crucial factor in giving Deutsche Bank a larger client base to potentially cross-sell to. It is also indicative of an understanding and a strategic view on agency securities lending from the bank's franchise in the US.

"We are a very efficient product for the bank as well as our clients, so it makes sense they would use us and continue to focus on us," says Nigam.

Deutsche Bank has previously referred to the trend for some of the largest institutional investors in the world to separate custody or securities services from lending.

"The decoupling of custody from securities lending has been going on in the US for more than a decade now," explains Nigam. "Many of the largest ETF and mutual fund providers as well as pension funds in the US have committed to non-custodial securities lending solutions. These include Blackrock, Fidelity, Janus Henderson and two big Californian pension systems, to name just a few"

A number of custody platforms have also set up their own third party lending agents in an attempt to capture some of this market given clients' growing preference for such a model.

"I think this trend will continue - custody platforms are trying to fight back by reducing custody fees where clients maintain their securities lending with them as well," says Nigam. "It is also dependent on the client's priorities. You want to go for the best in class and a pure third party lending agent is focused on service, revenue and risk, whereas a custody platform doesn't necessarily have the same focus on the securities lending part of their offering."

He observes that Deutsche Bank's clients have had to make a conscious decision to decouple securities lending from custody and the fact that they haven't gone back is a testament to their satisfaction with this decision.

"Some clients don't want to engage too much with securities lending and are happy to leave it to the custody platform to do that," concludes Nigam. "Other clients see securities lending as a real opportunity to make that incremental revenue and really want to maximise it within risk managed boundaries and are looking for third party agents to do that for them." ■