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Securities Finance Industry Trends:

Technology, Continuous improvement, and Innovation

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WHICH REGULATORY DEVELOPMENTS HAVE HAD THE MOST IMPACT ON YOUR SECURITIES LENDING AND FINANCING BUSINESS IN 2021?

Regulatory requirements continue to drive and shape the demands and needs of the borrowers with agent lenders adjusting to these ever-changing needs.

The borrowing community is solving for regulatory initiatives including Liquidity Cover Ratio HQLA-ability to meet short term obligations, and Net Stable Funding Ratio (NSFR) which is the liquidity standard requiring banks to hold enough stable funding to cover the duration of their long-term assets. As a result of such requirements, we have seen an influx of term loans including Government of Canada bonds, U.S. Treasuries, and Provincial debt. We've also seen an increase in demand for transformation trades as borrowers look to upgrade lesser forms of collateral such as equities for HQLA.

In Canada, there has been an uptick in term loans including transformation trades in the program as Canada's Office of the Superintendent of Financial Institutions (OSFI) required the Canadian Chartered Banks to start reporting the Net Stable Funding Ratio (NSFR) at the end of 2020. Canadian dealers are also solving for Liquidity Cover Ratio. These regulatory requirements have resulted in an increased reliance on securities lending activity as a liquidity tool.

Furthermore, Large Exposure/Counterparty Credit Limits (SCCL) has resulted in agent lenders having to further diversify their borrower base along with considering other routes to market such as utilizing a CCP. It has also highlighted the cost of indemnification for agent lenders.

WHAT DO YOU PREDICT WILL BE THE BIGGEST REGULATORY CHALLENGES TO FACE BUY-SIDE AND SELL-SIDE FIRMS, ALONG WITH THEIR CLIENTS, IN 2022?

In terms of other market updates, Canadian and U.S. market stakeholders, including U.S. and Canadian central depositories, the Canadian Capital Markets Association (CCMA), and industry participants such as CIBC Mellon, have begun work designed to shorten the settlement cycle in Canada to T+1, the day after trade date. CIBC Mellon is playing an active role in the readiness for T+1 and consultations are taking place across the industry leading up to the implementation.

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IN CANADA WE ARE ALSO SEEING A RISING TREND AROUND SCALE AND CONSOLIDATION – THIS INCLUDES ASSET MANAGERS SEEKING TO GROW AUM AND MAKE ACQUISITIONS AS WELL AS CONSOLIDATION IN THE CANADIAN PENSION SPACE WITH SMALLER PLANS JOINING LARGER ORGANIZATIONS EITHER VIA MERGER OR BY ENTRUSTING ASSET MANAGEMENT MANDATES TO HIGH SCALE PLAYERS.

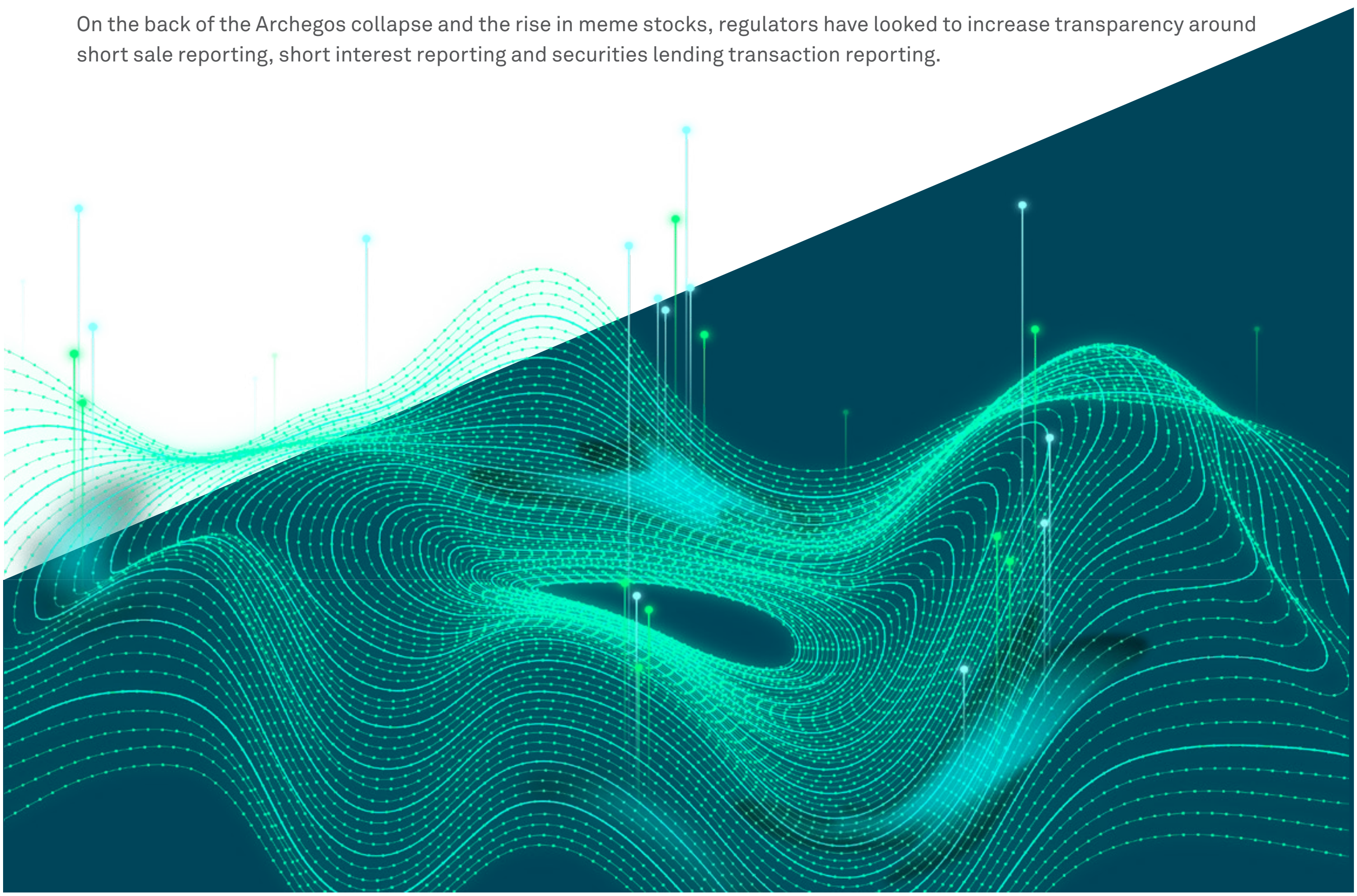
This has implications for securities finance as those larger players have the scale and sophistication to have more advanced needs in the securities finance space, which can also help them unlock opportunities as they seek to achieve results for their members. There are of course a large number of smaller, highly sophisticated firms that are engaging with innovation and flexibility to unlock opportunity.

THERE IS A NEED FOR DATA TO SUPPORT THE CHANGING INVESTMENT STRATEGY. THE DEMAND FOR ANALYTICS ONLY INCREASES IN A VOLATILE MARKET AS INDUSTRY PARTICIPANTS AIM TO INSULATE THEIR ASSETS FROM RISK OR TRY AND FIGURE OUT WAYS TO CAPITALIZE ON THE VOLATILITY AND FURTHER GROW THEIR ASSETS.

Timely and accessible data can help inform asset allocation, improve investment performance, support governance and achieve many other imperatives. Better data tools can also help address the rapidly growing demand for increased transparency, in particular around private asset classes and multi-asset portfolios.

A range of allocation and investment strategies came into play in a turbulent market environment. Deploying reserve capital for opportunistic acquisition, repositioning holdings in alignment to broader economic trends (for example, a rise in interest in logistical infrastructure to support a rise in e-commerce), growing interest in areas such as private credit/debt, or even questions related to the nature and degree of support that should be afforded to portfolio companies suddenly struggling amid the pandemic environment.

On the back of the Archegos collapse and the rise in meme stocks, regulators have looked to increase transparency around short sale reporting, short interest reporting and securities lending transaction reporting.



> In Canada we are seeing a rising trend around scale and consolidation – this includes asset managers seeking to grow AUM and make acquisitions as well as consolidation in the Canadian pension space with smaller plans joining larger organizations either via merger or by entrusting asset management mandates to high scale players.

HOW HAVE ATTITUDES TOWARDS THE ENFORCEMENT OF ESG CHANGED OVER THE PAST YEAR AND HOW DOES THIS AFFECT THE ESG MOVE FORWARD INTO 2022?

TODAY'S COMPLEX MARKET CHALLENGES INCLUDE THE GROWING NEED FOR BOTH GREATER CONSISTENCY IN, AND INCREASED ACCESS TO, THE BEST PRACTICES OF ESG INVESTMENT.

Among these best practices is the need for customization to reflect individual preferences, standards to support the ESG investment process, and demonstrability of ESG representation in sustainable investments.

An increasing array of institutional and individual investors are mobilizing around the business case behind considering environmental, social and governance (ESG) factors in investment decisions. According to the 2020 Canadian RI Trends Report, there were $3.2 trillion in responsible investment assets under management (AUM) in Canada with a 48 per cent growth over a two-year period. This represents 61.8 per cent of Canada's investment industry. Canadian investors have become more particular about how they deploy their capital and seek to deliver returns with ESG factors as a key consideration.

As organizations think about their investment allocations, investment management, performance/compliance monitoring and operational efforts in the years ahead, the opportunity to align their purpose with what they do and how they do it will likely continue to rise – as will pressure from data that increasingly correlates value and values around the incorporation of ESG factors. Investors' rapidly evolving attitudes and explorations of ESG have set their influence on a macro level. It is driving change not only in the way organizations go about their business, but also in the way it defines itself and thinks about its own role in the world.

Canada has overall seen very strong momentum in the ESG space. Large asset owners and asset managers have issued an array of ESG commitments. For example, TELUS issued Canada's first sustainability-linked bond, raising C$750 million and committing to reducing its greenhouse gas emissions by 46% from 2019 levels by 2030, or else the interest payable on the notes will increase by 1.00% per annum. We saw a large investor statement on ESG, with institutional investors responsible for $5.5T in assets making a statement. Fitting for this momentum, the North American office of the International Sustainability Standards Board (ISSB) was also announced as being located in Montreal, further cementing the regional hub as a centre of excellence around ESG.

WHAT ARE THE MAIN CHALLENGES IN APPLYING SUSTAINABLE LENDING AND REPO ACTIVITY AND HOW WILL THESE IMPACT YOUR BUSINESS DURING 2022?

One of the challenges with ESG is the concept of 'investment horizon'. There are many studies to support that performance is not sacrificed by incorporating ESG strategies into investment decisions. However, a company investing in sustainable practices might not see that value creation and value appreciation until maybe 10 or 20 years later. Therefore, you end up dealing with retail or institutional investors who are understandably sensitive to short-term shocks, which could actually deter them from making long term commitments to ESG investing.

We've been focused on what the data and analytics solutions need to be for our clients to help them navigate the evolution of ESG. We've built an application that introduces the concept of 'crowdsourcing metrics' to address the sustainability challenges and allows you to compare what your priorities are so that you can realize your strategies – it allows us to harness the wisdom from the crowd and use it to create data for different clients, so that you can actually see how others are using various ESG factors in their analysis.

We are currently at a tipping point as the value proposition on ESG continues to rapidly change and develop, and institutional investors make commitments and deploy capital – either to access upside opportunity, to mitigate risks, or in response to pressure from their stakeholders. As more organizations consider how to incorporate ESG into their everyday processes, they will still be faced with challenges in determining which sources of ESG best align with their investment approach. Therefore, looking ahead, we anticipate continued and evolving discussions with our clients on their approaches.

> "There is a need for data to support the changing investment strategy. The demand for analytics only increases in a volatile market as industry participants aim to insulate their assets from risk or try and figure out ways to capitalize on the volatility and further grow their assets."

WHAT WILL BE THE MAIN DRIVERS OF LIQUIDITY IN SECURITIES LENDING AND FINANCING MARKETS DURING 2022? WHAT ARE YOUR PREDICTIONS FOR THE MARKET IN TERMS OF LOAN SUPPLY, BORROWER DEMAND AND OPPORTUNITIES FOR GENERATING LENDING REVENUE?

Market stakeholders will be watching central bank actions carefully around rates, quantitative easing and more. Collateral flexibility will remain a key focus. We also expect borrowers and lenders to continue to become more sophisticated, taking interest in data and reporting. Canada is next to the world's largest, most liquid market and as a result we continue to place a premium on innovation, technology and resiliency. Canada has earned many global market firsts – the first ETF, the first cannabis securities, first publicly traded cryptocurrency funds and more. Canada is blessed with large reserves of natural resources, a highly educated population and an engaged regulatory environment that works collaboratively with participants to help us achieve the highest standards for investors. The features that set Canada apart are also positive for our securities lending and finance markets; we expect that the same attributes that have driven our success will continue in the year ahead.

WHAT LESSONS HAVE WE LEARNT DURING THE PERIOD OF VOLATILE LIQUIDITY THAT FOLLOWED THE ARRIVAL OF THE COVID-19 PANDEMIC IN MARCH 2020? HOW HAVE YOU ADAPTED YOUR STRATEGY TO MANAGE THIS IN SUPPORTING CLIENTS?

Canada's financial markets shared in the significant disruption triggered by the global COVID-19 pandemic. The market correction that followed from the onset of COVID-19 saw tremendous volatility and extremely high volumes of investment operations. This came in concert with profound operational transition which saw financial institutions adapting and expanding remote work environments and business continuity actions, while also handling an unusually high spike in volume. We saw the continued role of securities finance in enabling that market liquidity, as well as the level of engagement of Canadian beneficial owners in lending generally, play out through the depths of the crisis as from our perspective this market function performed well.

Canadian governments at the federal and provincial level also stepped in with an array of relief measures to support individuals, businesses and the broader economy through the pandemic while working to "flatten the curve." The Bank of Canada reduced its benchmark lending rate through a series of rate cuts during March 2020 in response to the pandemic. Other stabilizing measures were also launched by the BoC in order to support and uphold the stability and functioning of Canada's financial system. For example, the Bank of Canada established several large-scale asset purchase programs to help enable liquidity. With those measures, Canada's financial system remained stable during the height of volatility and continues to properly function in the "new normal." Furthermore, in response to challenges related to the COVID-19 pandemic, Canadian tax authorities developed some significant tax measures to support Canadians and businesses.

CIBC Mellon knows how strongly clients value resiliency and robust governance. To this end, we are committed to sustaining resilient capabilities designed to maintain operations in the face of business disruptions. Our response to the pandemic was underpinned by our business continuity program, and this supported the stable delivery of products and services to our clients throughout this pandemic. We continue to maintain open lines of communication and collaboration with our employees, clients, vendors and other stakeholders to work through these challenging times together.

One critical aspect that we found was both a key achievement and a major success factor: staying connected and keeping communications channels open even as we were physically separated. Our teams actively engaged with clients and employees, keeping them informed – for example, frequent employee, management and leadership meetings, detailed and regular client updates across multiple formats, and regular employee calls and messaging.

> "Today's complex market challenges include the growing need for both greater consistency in, and increased access to, the best practices of ESG investment."

WHICH SECTORS WITHIN THE SECURITIES FINANCE INDUSTRY WILL SEE THE MOST SIGNIFICANT ADVANCES IN TERMS OF TECHNOLOGY DEVELOPMENT DURING 2022?

We expect a continued focus on technology innovation and automation across industry participants – in particular we believe the remote pandemic-driven environment has further accelerated long term trends related to digitization, remote working, and the streamlining of operating models as organizations focus increasingly tightly on the areas where they can most deliver core value to clients – while outsourcing non-core activities to providers that can offer the necessary scale, technology and expertise to deliver success.

WHAT ARE THE PRIORITIES IN TERMS OF ELIMINATING TRADING AND POST-TRADE EFFICIENCIES IN SECURITIES FINANCE MARKETS? AND IN DRIVING STANDARDIZATION AND DIGITIZATION OF PROCESS FLOW?

As an industry, we are continuously looking improve the efficiency and resiliency of our markets. Standardization, digitization and governance will remain key focus areas. We will of course continue to drive these values at our enterprise.

For Canada more broadly, one area we will see effort is in helping the industry prepare to shorten the settlement cycle to T+1 from T+2. The Canadian Capital Markets Association (CCMA) has reformed to bring together participants like custodians, buy side firms, sell side firms, as well as regulators and industry associations like the Canadian Securities Lending Association to work collaboratively to help the industry mitigate risks and support a smooth transition. The CCMA has affirmed its intent that Canada should align to the United States in timing, given the interconnectedness of the two markets.

ARE YOU SET TO BE RELEASING OR WORKING ON NEW TECHNOLOGY IN THE COMING YEAR?

Our global enterprise has seen clients looking for more integrated capabilities across our parent companies – bringing in global data solutions, or local market correspondent banking for example, and helping clients access markets.

The usage of technology to further automate securities financing transactions has been an ongoing development in the marketplace. Participants are looking for more automation, greater transparency into investment activities, and flexible and timely access to data – all while respecting and navigating a rapid rise in regulatory and market complexity.

The impact of greater automation and technological innovation is consistent with the broader themes: more efficient, effective and transparent investment operations, and ultimately greater optimization outcomes for clients. From the first straight-through processing to today's data-driven investment operations – these themes have been running for decades, though the pandemic-driven remote environment has further accelerated them.

WHAT ARE YOUR PRIORITIES AND HOPES FOR 2022?

Market participants continue to take confidence from Canada's stable financial sector and the country remains an investment destination of choice for many global financial institutions. Canada maintains one of the few remaining triple-A ratings for sovereign debt, and continues to attract global investors with its robust market infrastructure, efficient settlement mechanisms and effective regulatory environment.

> "Long term predictions are often a challenge, but looking ahead to the next year, a few themes will likely remain consistent. Technology, continuous improvement, innovation, and of course ongoing effort by the CIBC Mellon team to strengthen relationships and build solutions and bring clients the best of both worlds: local expertise, global capabilities."

For more information

Contact your Relationship Executive or Relationship Manager or visit www.cibcmellon.com.

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