



Securities-Backed Lending – December 2019

We provide clients with access, via their custody bank, to credit facilities that are backed by their securities portfolio (referred to as *securities-backed lending* or “SBL”). Amounts drawn down can be used for any purpose, including to purchase additional securities (which increases leverage within the portfolio).

The interest rate is attractive, and there are no set-up, funding or commitment fees, making this an attractive form of short-term liquidity. In our case, the interest income is earned by the custody bank.

Recent media coverage has described concerns raised about SBL programs, as previously flagged by the U.S. FINRA and industry commentators. SBL can be seen as attractive to asset managers because they are an additional source of income, the assets under management become collateral thus seen as stickier, and if SBL is used for portfolio leverage, then AUM (and management fees) increase.

We have found that this accommodation is particularly helpful for clients that have frequent short-term liquidity needs in connection with real estate or other property purchases. Draw-downs under an SBL are less disruptive to the portfolio strategy than are unplanned withdrawals, to be added back to the portfolio sometime later.

The total amounts drawn by our clients under SBL have declined over the past 18 months; we believe consistent with broad industry experience. Currently, they are under 10% of total AUM. Their use has been, roughly, evenly split between short-term funding for personal expenses and increased investment portfolio leverage.

Most of the portfolios we manage represent retirement funds, as opposed to shorter-term performance-oriented funds. We very much discourage imprudent use of leverage and are able to monitor client leverage. Given this careful use of SBL by our clients, as well as the flexible and low-cost nature of the facilities, we are confident that SBL is a valuable additional client service.

However, some wealth managers heavily market SBL, with the result that total amounts outstanding have increased relative to AUM in the past five years.

Conduct issues remain a challenge for our industry and its reputation. Accordingly, we believe that given the commercial incentives to some managers and financial advisors to potentially abuse this product, regulatory enquiries as to how they are marketed and whether “mass affluent” and other retail investors appreciate the risks posed by misused SBL, are fully warranted.

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