Insights
Hybrid

September 2023

Unlocking Portfolio Potential with Securities Lending

A well-managed securities lending program can be a valuable portfolio management tool, and can enable funds to receive an additional source of income that can add incremental risk-adjusted returns to a fund's overall investment return objective.

Since the 1970s, investors have engaged in securities lending. It is now a well-established practice in the investment management industry as a way to generate extra revenue to a portfolio. The process involves transferring securities like stocks or bonds to a third party (called a borrower). The borrower gives the lender collateral in exchange for the security and pays a fee. The collateral acts as a form of insurance in case the security is not returned. The lender earns the fee, which helps improve performance.

As a practice, securities lending is attractive because it:

- Generates additional revenue/performance in a portfolio that may be used to offset operational expenses, custody costs, and management fees
- Improves price transparency in the market, and potentially, helps prevent artificial price bubbles
- Facilitates improved market liquidity, reducing market execution costs overall

For SPDR ETFs, one of the key reasons for engaging certain ETFs in a lending program revolves around improving the total cost of ownership (TCO) of the funds by helping offset some of the costs associated with tracking (from trading costs to taxes and custody and management fees).

In this article, we explain how securities lending works for the SPDR European-domiciled ETFs, the governance of the program and the limits imposed on the range. Please always refer to the relevant prospectus for more details (Prospectus SSGA SPDR ETFs Europe II plc- Annual Update — 28 October 2022, Prospectus SSGA SPDR ETFs Europe I — 28 October 2022).

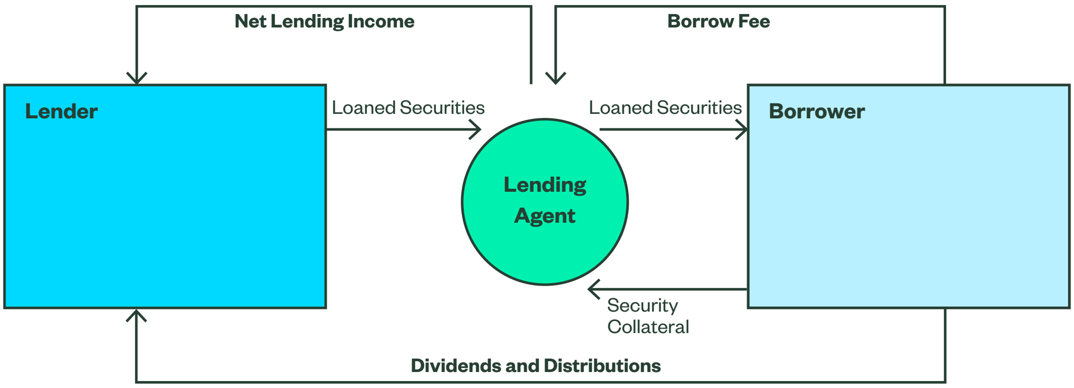
What is Securities Lending?

A securities lending transaction involves the temporary transfer of securities from one party (the lender) to another party (the borrower). Frequently, a securities lending agent (the agent) is employed by the lender to facilitate the transaction. Securities lending enables funds enrolled in the securities lending program to potentially generate an additional source of income.

The borrower pays a fee to the lender for borrowing the securities. Sometimes, if cash is transferred as collateral, the borrower may expect interest to be paid on the cash (a rebate). In this case, instead of a borrow fee, the lender will earn the interest differential between what is earned by investing the cash in money markets and the rebate due to the borrower. The agent will typically retain a portion of the borrow fees, or interest differential, as a fee for their service. In SPDR's securities lending program, cash in not accepted as collateral.

During the term of the loan, the collateral is marked to market daily. The borrower is obligated to forward all distributions and dividends arising during the period of the loan to the lender, so the lender receives the economic benefits as if the securities were held in custody. The lender does forfeit the right to exercise proxy voting rights of the security arising during the period of the loan. The loan may be closed any day at the discretion of the either the borrower or the lender.

Figure 1
How the Securities Lending Program Works



The information contained above is for illustrative purposes only.

Potential Risks

As with all investment activities, securities lending bears risk. Here are some of the key risks and mitigants typically used to control the risk.

Figure 2
Risk & Mitigation

Risk	Description	Mitigants
Reinvestment Risk	• Risk of loss in cash collateral reinvestment (credit, interest rate, liquidity, etc.) • Generally, the largest risk in funds accepting cash collateral	• Avoidance of Cash Collateral • Conservative management of cash collateral reinvestment fund
Borrower Default Risk	• Risk of borrow/counterparty defaulting (e.g. bankruptcy) and unable to return securities to the lender	• High quality borrower selection • Over-collateralization / daily mark-to-market • Accepted collateral types, diversification, liquidity testing • Borrower default indemnification
Operational Risk	• Risk of failed settlements due to securities on loan • Miscommunication of corporate action elections • Tax and regulatory guideline breaches, etc.	• Fund limits with buffers relative to regulatory guidelines • Position limits with buffers • Capabilities and breadth of lending agent • Strong communication and operational controls

Source: State Street Global Advisors, as of 31 August 2023.

While not without risk, a well-managed securities lending program can help to unlock an additional source of income in portfolios. As one of the world's largest financial institutions, State Street Global Advisors has the scale and global reach to deliver clients the potential benefits of securities lending while carefully managing risk and cost.

Governance

The State Street Global Advisors Securities Lending Committee (Committee) oversees and comprehensively reviews performance and effectiveness of the State Street Global Advisors Global securities lending programs.

The Committee evaluates the performance of the State Street Global Advisors securities lending agents. It also reviews and challenges State Street Global Advisors' global securities lending programs against industry standards and performance, current risk appetite levels, and current market conditions.

In addition, the securities lending program for each participating fund is reviewed, approved and overseen by the respective fund boards.

About the Lending Agent: State Street Bank and Trust Company

State Street Bank and Trust Company (SSBT), which has been appointed as lending agent, is one of the world's most experienced lending agents, providing both custodial and third-party lending services covering more than 30 international markets. SSBT operates through entities within the State Street group of companies (which are affiliates of State Street Global Advisors). SSBT has been providing securities lending services since 1974, and now operates from trading desks based in London, Boston, Hong Kong, Toronto and Sydney.

This international presence provides local expertise and 24-hour access to the securities lending markets. SSBT offers considerable depth of inventory and market presence, thus attracting high credit-quality borrowers and providing insights into the level of demand for securities.

SSBT employs a number of safeguards for clients engaged in securities lending, including:

- Indemnifying clients against borrower default
- Monitoring the daily activity of the borrowers
- Maintaining liquid collateral with appropriate margins
- Ensuring collateral diversification

Indemnification

SSBT provides a borrower default indemnity as part of the contractual agreement as lending agent for the funds. If a borrower defaults, and fails to return a lent security to a fund, SSBT will liquidate the collateral held and repurchase the lent security in the market with the proceeds. Should those proceeds be insufficient to replace the security and all associated cash flows due to the fund, SSBT will cover the difference. Should the security not be available for purchase, SSBT will credit the fund an amount of cash equal to the market value of securities and associated cash flows due.

Approved Borrowers

State Street Global Advisors has a dual review and approval process for borrowers in the securities lending program. Counterparties are reviewed and approved by the State Street Global Advisors Counterparty Risk Management (SSGA CRM) team and the lending agent, State Street Bank and Trust (SSBT). Both quantitative and fundamental approaches are leveraged in evaluation of borrowers. Borrowers are also subject to a continuous monitoring regime to identify developments that may impact the creditworthiness of a borrower. Generally, it is State Street Global Advisors' practice to approve the largest and strongest participants in any market.

Collateral

Forms of acceptable collateral are limited to:

- Government securities whose long-term debt ratings are at or above A- (or a rating equivalent) by two or more internationally recognized rating agencies
- Select equity securities that are traded on a regulated market that operates regularly and are officially recognized and open to the public
- Select Supranational Bonds

The collateral amount is marked to market daily. If collateral levels are insufficient for a particular loan, the borrower is required to provide more collateral. If the loan is over-collateralised, the lending agent may return some of the collateral to the borrower. Collateralisation levels are frequently negotiated between 102–110%. This is often above the contractual minimums and based on the liquidity, price volatility, and currency of individual instruments.

Lending Limits

The percentage out on loan will depend on the type of fund and securities held:

- Maximum of 95% on loan for a single security on a per-fund basis.
- The aggregate outstanding value of loaned securities for any fund in the ETF range shall not exceed 70% of its total net asset value for fixed income ETFs and 40% for equity ETFs.

Securities Lending Revenue and Costs

Various fees may be assessed to operate a securities lending program including revenue sharing fee-splits, cash collateral management fees, administrative and operational fees. However, SPDR simplifies this and only assesses a single fee-split. A fee-split is a form of revenue sharing whereby the agent lender retains a portion of the program revenue, and covers all operating costs and expenses associated with executing the program and providing the indemnification. State Street Global Advisors as investment manager does not receive compensation for overseeing the lending program, and all revenues arising from securities lending in respect of an ETF, net of the fee-split, are returned to the fund.

The funds enrolled in the securities lending program receive 75% of the gross securities lending revenue, while the lending agent receives 25%. These revenues are paid net to the fund on a monthly basis.

Revenues from securities lending vary between funds and overtime based on many factors. Some of the key factors include: market demand for specific securities held by a fund, design of the lending program including specific risk controls, general market conditions for interest rates and collateral, and efficient execution of the program by the lending agent.

Transparency

At State Street Global Advisors, we believe transparency is key to understanding securities lending and building trust with our clients. Further, it is important for our clients to have ready access to lending program dynamics to assess both the returns and the risks associated with the lending program. To this end, State Street Global Advisors publishes a quarterly report available on the SPDR website disclosing securities lending performance and various risk metrics for the program. These metrics include returns received by the fund, the percent of the fund on loan, summary and detailed listings of collateral held, summary of loan exposure to borrowers, etc.

Securities Lending Report

The Securities Lending Report is regularly updated and available on ssga.com.

Want to Know More

For a discussion on lending units of ETFs, please see: Unlocking the Securities Lending Potential of UCITS ETFs (ssga.com).
For more reading on the debate on whether to lend or not, please read State Street Associates' Travis Whitmore's piece "To lend or not to lend, An academic review of securities lending's impact on asset prices and fund performance" published in January 2023.

Appendix

SPDR ETFs Engaged in Securities Lending from 25 October 2023

SSGA SPDR ETFs Europe I plc

SPDR Bloomberg 0–3 Year U.S. Corporate Bond UCITS ETF	SPDR Bloomberg Euro Corporate Bond UCITS ETF
SPDR Bloomberg 10+ Year U.S. Corporate Bond UCITS ETF	SPDR Bloomberg Euro Government Bond UCITS ETF
SPDR Bloomberg 1–10 Year US Corporate Bond UCITS ETF	SPDR Dow Jones Global Real Estate UCITS ETF
SPDR Bloomberg U.S. Aggregate Bond UCITS ETF	SPDR FTSE EPRA Europe ex UK Real Estate UCITS ETF
SPDR Bloomberg 10+ Year U.S. Treasury Bond UCITS ETF	SPDR S&P U.S. Dividend Aristocrats UCITS ETF
SPDR Bloomberg 7–10 Year U.S. Treasury Bond UCITS ETF	SPDR S&P 500 UCITS ETF
SPDR Bloomberg Euro High Yield Bond UCITS ETF	SPDR S&P 500® Low Volatility UCITS ETF
SPDR Bloomberg 1–3 Month T-Bill UCITS ETF	SPDR S&P® 400 U.S. Mid Cap UCITS ETF
SPDR Bloomberg Euro Aggregate Bond UCITS ETF	SPDR SPDR MSCI World UCITS ETF (Acc)
SPDR Bloomberg Sterling Corporate Bond UCITS ETF	SPDR FTSE UK All Share UCITS ETF
SPDR Bloomberg Emerging Markets Local Bond UCITS ETF	SPDR MSCI EMU UCITS ETF
SPDR Bloomberg Global Aggregate Bond UCITS ETF	SPDR MSCI Japan UCITS ETF
SPDR Bloomberg 1–3 Year U.S. Treasury Bond UCITS ETF	SPDR MSCI ACWI UCITS ETF
SPDR Bloomberg 1–5 Year Gilt UCITS ETF	SPDR MSCI Emerging Markets UCITS ETF
SPDR Bloomberg 15+ Year Gilt UCITS ETF	SPDR S&P Pan Asia Dividend Aristrocrats UCITS ETF
SPDR Bloomberg 3–7 Year U.S. Treasury Bond UCITS ETF	SPDR S&P Global Dividend Aristocrats UCITS ETF
SPDR Bloomberg U.S. TIPS UCITS ETF	SPDR MSCI EM Asia UCITS ETF
SPDR Bloomberg U.S. Treasury Bond UCITS ETF	SPDR MSCI Emerging Markets Small Cap UCITS ETF
SPDR Bloomberg UK Gilt UCITS ETF	SPDR S&P Emerging Markets Dividend Aristocrats UCITS ETF
SPDR Bloomberg 0–3 Year Euro Corporate Bond UCITS ETF (Dist)	SPDR MSCI ACWI IMI UCITS ETF
SPDR Bloomberg 10+ Year Euro Government Bond UCITS ETF	SPDR S&P Euro Dividend Aristocrats UCITS ETF
SPDR Bloomberg 1–3 Year Euro Government Bond UCITS ETF	SPDR S&P UK Dividend Aristocrats UCITS ETF

SSGA SPDR ETFs Europe II plc

SPDR Bloomberg 0–5 Year Sterling Corporate Bond UCITS ETF	SPDR S&P U.S. Communication Services Select Sector UCITS ETF
SPDR Refinitiv Global Convertible Bond UCITS ETF	SPDR S&P U.S. Consumer Discretionary Select Sector UCITS ETF
SPDR ICE BofA 0–5 Year EM USD Government Bond UCITS ETF	SPDR Russell 2000 US Small CAP UCITS ETF
SPDR Bloomberg 3–5 Year Euro Government Bond UCITS ETF	SPDR S&P U.S. Energy Select Sector UCITS ETF
SPDR S&P U.S. Industrials Select Sector UCITS ETF	SPDR S&P U.S. Materials Select Sector UCITS ETF
SPDR S&P U.S. Technology Select Sector UCITS ETF	SPDR MSCI Europe Small Cap Value Weighted UCITS ETF
SPDR S&P U.S. Consumer Staples Select Sector UCITS ETF	SPDR MSCI World Small Cap UCITS ETF
SPDR S&P U.S. Financials Select Sector UCITS ETF	SPDR EURO STOXX Low Volatility UCITS ETF
SPDR S&P U.S. Health Care Select Sector UCITS ETF	SPDR MSCI World Value UCITS ETF
SPDR S&P U.S. Utilities Select Sector UCITS ETF	SPDR MSCI Europe Value UCITS ETF
SPDR MSCI USA Small Cap Value Weighted UCITS ETF	SPDR Morningstar Multi-Asset Global Infrastructure UCITS ETF
SPDR MSCI USA Value UCITS ETF	

Appendix

Previous Existing Securities Lending ETFs:

SPDR MSCI Europe Communication Services UCITS ETF	SPDR MSCI Europe UCITS ETF
SPDR MSCI Europe Consumer Discretionary UCITS ETF	SPDR MSCI World Communication Services UCITS ETF
SPDR MSCI Europe Consumer Staples UCITS ETF	SPDR MSCI World Consumer Discretionary UCITS ETF
SPDR MSCI Europe Energy UCITS ETF	SPDR MSCI World Consumer Staples UCITS ETF
SPDR MSCI Europe Financials UCITS ETF	SPDR MSCI World Energy UCITS ETF
SPDR MSCI Europe Health Care UCITS ETF	SPDR MSCI World Financials UCITS ETF
SPDR MSCI Europe Industrials UCITS ETF	SPDR MSCI World Health Care UCITS ETF
SPDR MSCI Europe Materials UCITS ETF	SPDR MSCI World Materials UCITS ETF
SPDR MSCI Europe Small Cap UCITS ETF	SPDR MSCI World Technology UCITS ETF
SPDR MSCI Europe Technology UCITS ETF	SPDR MSCI World Industrials UCITS ETF
SPDR MSCI Europe Utilities UCITS ETF	SPDR MSCI World Utilities UCITS ETF

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Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $3.8 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of June 30, 2023 and includes approximately $63 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Investing in high yield fixed income securities, otherwise known as "junk bonds", is considered speculative and involves greater risk of loss of principal and interest than investing in investment grade fixed income securities. These Lower-quality debt securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

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