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Boardroom Revolution: ESG Data, Ai and Engagement Future Proofing Financial Markets

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As part of the preparatory work ('travaux préparatoires') of the G7 Pensions Forum held later this month in the UK, on the sidelines of the G7 Summit (Carbis Bay), the authors sat with experts from key jurisdictions, including the United Kingdom, the United States, the European Union, Australia, China and the MENA area, to discuss issues such as 'the firm of the future', fintech, financial regulation/governance and the rise of fiduciary capitalism in the 'Post-Covid Era'.

ESG & Securities Lending: Europe Leading by Example

The Covid Crisis saw various jurisdictions, including **France, Italy, Japan** and **South Korea** impose temporary short selling bans, with financial regulators acting sometimes abruptly, especially in Southern Europe and **Indonesia**. Some of these prohibitions have had surprising consequences: for the period March 2020 – April 2021 when a strict short selling ban was in place in South Korea, "individual [retail] traders have come to take up about three quarters of the market's daily trading volumes in amid the pandemic" […] Korea has put in place the longest short selling ban that we've seen. The market currently is at a record level, volatility has come down significantly back to pre-Covid levels, so the industry is encouraged to see the short-sell ban now being lifted."[1]

In London, the **International Securities Lending Association** (ISLA) was prepared for the crisis, which they had largely anticipated: their original reflexion around notions such as 'ESG and securities lending', 'risk mitigation in an evolving regulatory environment' and 'short selling in times of crisis' go back to the start of the previous decade. **Ed Oliver**, board member & director, ISLA, chaired a special session on these issues at the IMN Summit in London as early as September 2014, with **Matthew Chessum**, Investment Director, Liquidity Management, Aberdeen, **Xavier Bouthors**, Head of Securities Lending, NN Investment Partners, **Nicolas Firzli**, DG, World Pensions Council and veteran ETF expert **Andrew Jamieson**. Andrew Dyson, CEO, ISLA, who delivered the opening keynote address, **Roelof van der Struik**, Treasury, **PGGM** Investments and **Roy Zimmerhansl**, then Board Member, Pan Asia Securities Lending Assn., **PASLA**, also spoke at that seminal event, laying the groundwork for future policy thinking and advocacy work.

We went back to London earlier this month to get a sense of the key trends reshaping the securities lending industry. **Andrew Dyson**, CEO, **ISLA**, made the following remarks : "As the sustainable finance agenda continues to gain further momentum, it is becoming apparent that we are moving rapidly from a development and concept phase, to one of implementation. To support this transition, ISLA will be channelling its ongoing ESG efforts through its existing steering and working group structures. Led by the ESG Steering Group, ISLA is now working within a new 'ESG Policy Framework', that is being developed around four key pillars: **Regulation, Advocacy** & **Consultations, Best Practice**, and Thought Leadership."

He went on to explain that "the first pillar will deal with specific legislation and policy outputs, together with responding to the developing taxonomy debate. The second will be a conduit for all relevant consultations, as well as helping to drive our advocacy efforts. The development and delivery of best practice will be the logical outcome of much of our ESG-related work, especially in areas such as **taxonomies**, **collateral screening, short selling**, and **voting**. Within this third pillar, we will therefore capture our best practice considerations and recommendations. The final pillar will focus on the development and delivery of thought leadership and educational messaging. It is important that ISLA drives broad and open debates on the pivotal role of securities lending within the capital markets, and our desire to align securities lending with ESG metrics."

Securities Lending, Sustainability and Risk Management: Learning from Europe, Canada and the Asia Pacific area

pictured here clockwise:

Andrew Dyson, CEO, Intl. Securities Lending Association, (**ISLA**)

G.S. Khoo, Cofounder, NTU Singapore Centre for Financial Engineering

Farrah Mahmood, Senior Regulatory Analyst, ISLA

Sohn Byung-doo, Chairman, Korea Exchange (KRX), key architect of South Korea's revamped short selling rules for institutional investors

To lead this important debate, Andrew Dyson, CEO, and **Farrah Mahmood,** Senior Regulatory Analyst, **ISLA,** co-authored a white paper titled 'Framing Securities Lending for the Sustainability Era' (March 2021), jointly with **Emma Dwyer,** Partner, International Capital Markets, **Matthew Townsend**, Partner, International Climate, Environment and Regulatory and Kelly Sporn, Senior Policy Advisor, International Climate, Environment and Regulatory, **Allen & Overy LLP**.[2] The white paper, available in the endnotes & resources section of this primer, also quotes the **Federal Reserve Bank of New York** (FRBNY), whose recent research seems to indicate that "short sales do not, in the long term, affect market declines […] The evidence does not suggest that short sellers are the problem. They are the messengers with bad news about companies' prospects. They are unpopular because they deliver messages that people would rather not hear."

We also talked to **Natalie Floate**, Head of Market & Financing Services, APAC, **BNP Paribas Securities Services**, to get a sense of market dynamics in the Asia Pacific, a strategic region emerging as the growth engine of the world economy in the 'Post Covid Era.' Ms. Floate is based in **Hong Kong**, she started her career at a global custodian in Sydney, supporting mandatory superannuation schemes (pension funds), which gives her a unique insight into the **Australia** pension market, one of the largest in the world, where we're currently seeing renewed appetite for securities financing products, as a result notably of the "secular quest for yields coupled with an increased focus on liquidity and collateral." Natalie Floate explained "most pension funds will be delegating the day to day running of their securities lending programmes to their custodian as agent lender, so it really comes down to what ESG capability your custodian has and how well they can act on your behalf - what they can put in place for you based on your own ESG objectives. This stretches from monitoring and controls to reporting, and importantly future flexibility as ESG evolves."

Boardroom Revolution: Shareholders Transforming Financial Markets

Regarding the **corporate governance** obligations and/or preferences of pension funds, including trustees, investment committees or board members overseeing the funds' investment activities, Ms. Floate reasoned that "when you lend a security you lose the right to vote"… "Now, some pension funds may think: I can't lend my assets because I like to **vote at AGMs** - that's actually incorrect!" In essence, your agent lender can help you tailor and structure your lending programme in such a way that you may reserve the right to recall or withhold some securities from lending, allowing you to retain the ability to vote if you wish to, particularly for your important local markets where you typically have the largest positions…At BNP Paribas, we can manage the voting process according to your requirements across your portfolio practically with you." This approach allows asset owners to earn incremental financial revenues, whilst meeting their responsibility with regards to being active, socially engaged shareholders.

G7 Pensions and Paris **Climate Finance Roundtable** (CFR) experts have been at the forefront of the "boardroom and courtroom revolution" now transforming financial markets. At the start of the last decade, the **World Pensions Council** (WPC) and the **OECD** helped convene the first international summits focusing on "the future of long-term investments in the post-Lehman era."[3] At the time, **Juan Yermo** (OECD), **Vincent Bazi** (WPC), Nicolas Firzli and the Hon. Nick Sherry thought the crisis could eventually usher a "paradigmatic shift", encouraging more pension fund trustees to "flex their fiduciary muscles" in favor of ESG informed forms of asset ownership.[4] These ideas were spearheaded by Dr. **Jeffrey Sachs**, then director of the **Earth Institute** at Columbia University, who co-chaired the WPC Climate Finance Roundtable (2 December, 2015) held on the sidelines of the **COP21**: "Every energy company in your portfolio needs to be scrutinised. 'Why is this [a company] we would want to hold over a five-to-twenty-year period?' […] We have to take a fiduciary responsibility – these are not good bets."[5]

The Intersection of ESG, Business Ethics and FinTech

David Weeks and Nicolas Firzli also sat with Dr. **Nizan Geslevich Packin**, Baruch College Zicklin School of Business, **City University of New York** (CUNY), whose pioneering research focuses on the "bloody crossroads" where ESG, business ethics and FinTech intersect. Noting that, in recent quarters, more and more corporations have made disclosures regarding their implementation of ESG-values in their operations, she drew our attention to the fact "in the absence of a uniform standard regarding such disclosures, their format varies greatly, which, as the **Securities and Exchange Commission** (SEC) recently described in a Risk Alert (April 9, 2021), causes risks."

Attempting to solve this standardization problem, global regulators launched various ESG-related initiatives: "for example, the EU's **Sustainable Finance Disclosure Regulation**[6] (SFDR), which went into effect last month, imposes mandatory ESG-disclosure obligations on financial institutions. Likewise, publishing a detailed Roadmap Towards Mandatory Climate-Related Disclosures.[7] Similarly**, Israel**'s financial regulators issued a call for proposals on ESG-disclosures, and published guidelines".[8]

Active Ownership: ESG, Ai, Deep Data Transforming Capital Markets

pictured here clockwise:

Jeffrey Sachs, Dir., **Center for Sustainable Development**, Columbia

Juan Yermo, CSSG, **OECD**

Vincent Bazi, Ch., **WPC**, BM, **Association of Intl. Wealth Managers**

Nizan Geslevich Packin, Ass. Professor, **Zicklin School of Business**, CUNY

Dr. Geslevich also noted that "in the U.S., corporations' disclosure requirements are mainly based on the information materiality. The SEC, however, might want to change this. It recently appointed a policy advisor on ESG-issues, which were [also] included in the SEC's 2021 Examination Priorities,[9] and it's soliciting comments on climate disclosure proposals. These SEC efforts are not criticism-free. Some commentators cautioned about the Commission's lack of expertise and political accountability to pursue such goals."

Finally, the authors met with Dr. **G.S. Khoo**, board member & ASEAN councillor, Singapore Economic Forum (SEF), fmr. Head of Enterprise Risk Management (ERM), **Alberta Investment Management** Corp. (AIMCo), one of **Canada**'s leading public pension investors.[10] Dr. Khoo, who has over 30 years of Ai, financial engineering and data mining work-experience across the region, including **Malaysia** and **Hong Kong**, sounded a cautionary note regarding the "quantitative naivety" of many in the financial industry, insisting on the need to integrate all available ESG metrics, including those which may seem "discontinuous" or irregular at first glance: "lifecycle data aggregation and systemic analysis across long time sequences are essential … Just like the intermittent *appearances of an aurora borealis*, timely alternative data analysis, when harnessed appropriately, can yield insightful and sometimes unexpected *visions* of ESG risks and returns"!

London, Paris, Melbourne, 7 June 2021

ENDNOTES & RESOURCES

[1] Youkyung Lee, "World's Longest Short-Selling Ban Coming to an End in Korea", Bloomberg, 26 April 2021

[2] "Framing Securities Lending for the Sustainability Era: ISLA-A&O White Paper", 18 March 2021 https://www.allenovery.com/en-gb/global/news-and-insights/publications/framing-securities-lending-for-the-sustainability-era-isla-ao-white-paper

[3] Firzli, M. Nicolas. "Pension Investment in Infrastructure Debt: A New Source of Capital." *World Bank blog* (2017)

[4] OECD WPC Pensions & Investments Forum, 10 Dec. 2010 https://worldpensions.org/2nd-world-pensions-forum

[5] Andrew Pearce, "Jeffrey Sachs: Fund managers Have a Duty to Dump Fossil Fuels", Financial News, 7 Dec. 2015 https://www.fnlondon.com/articles/sachs222-20151207

[6] See notably BNP Paribas, "Sustainable Finance Disclosure Regulation (SFDR): Regulation Memo", 29 March 2021 https://securities.cib.bnpparibas/sustainable-finance-disclosure-regulation-sfdr-regulation-memo/

[7] HM Treasury , Roadmap Towards Mandatory Climate-Related Disclosures, November 2020

[8] cf. investment guidance iss. by Israel's Capital Market, Insurance and Savings Authority (CMISA), Feb. 2021
תיקון הוראות החוזר המאוחד – פרק 4 לשער 5 "ניהול נכסי השקעה" (שיקולי השקעה הנוגעים להיבטים סביבתיים, חברתיים והיבטי ממשל תאגידי ולסיכונים מתפתחים, סיכוני סייבר וסיכונים טכנולוגיים)

[9] SEC DOE Announces 2021 Examination Priorities: Enhanced Focus on Climate-Related Risks, March 3, 2021

[10] for a detailed analysis of Canada's provincial public pension funds, see notably Firzli, Nicolas J., and Joshua M. Franzel. "Non-Federal Sovereign Wealth Funds in the US & Canada: Asset Accumulation and Investment in Developed Economies." *Revue Analyse Financière* 52 (2014) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3166671